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Becker v. Becker, 131 Nev. Adv. Op. 85 (Oct. 29, 2015)

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BUSINESS LAW: BANKRUPTCY

Summary

In response to a certified question by the United States Bankruptcy Court for the District of Nevada, the Court concluded that under NRS 21.090(1)(bb) a debtor can exempt his stock in the corporations described in NRS 78.746(2), but his economic interest in that stock is still subject to the charging order remedy in NRS 78.746(1).

Background

On his Chapter 7 bankruptcy petition, Ernest Becker claimed exemption under NRS 21.090(1)(bb) for corporate stock from two entities totaling \$1,581,000. Several creditors, interested parties, and the bankruptcy trustee objected, arguing that the statute only exempted the debtor's noneconomic interest in the corporate stock. After a hearing on the matter, the bankruptcy court certified a question to the Nevada Supreme Court, inquiring whether the exemption is limited to the debtor's noneconomic interest in the corporation.

Discussion

NRS 21.090(1)(bb) does not provide for a complete exemption of corporate stock

“When a debtor files a Chapter 7 bankruptcy petition, all of the debtor's assets become property of the bankruptcy estate ... subject to the debtor's right to reclaim certain property as ‘exempt.’”² Bankruptcy debtors in Nevada may claim the exemptions listed in NRS Chapter 21.

Here, debtor sought to exempt his stock in two closely held corporations pursuant to NRS 21.090(1)(bb). Debtor argued that he could exempt both his economic and noneconomic interest in the closely held corporations. In order to understand NRS 21.090(1)(bb), the court analyzed NRS 78.746.

Under NRS 78.746, creditors are able to obtain charging orders against a debtor's interest in small, nonpublic corporations.³ NRS 78.746 applies only to a corporation that: (1) has fewer than 100 stockholders of record at any time; (2) is not a publicly traded corporation or a subsidiary of a publicly traded corporation, either in whole or in part; and (3) is not a professional corporation as defined in NRS 89.020.⁴ NRS 78.746 limits the creditor's attachment to the debtor's *economic* interest in the corporations.⁵ Creditors are prohibited from attaching debtors' *noneconomic* interest in small corporations because “most ... closely-held corporations are family-owned and they would ... be disrupted” if creditors could take over management.⁶ NRS 78.746 strikes a balance by allowing creditors to satisfy their judgments without disturbing the corporation's management.⁷

¹ By Paul George.

² *Schwab v. Reilly*, 560 U.S. 770, 774 (2010).

³ NEV. REV. STAT. § 78.746.

⁴ *Id.*

⁵ *Id.*

⁶ Hearing on S.B. 317 Before the Assembly Comm. on Judiciary, 74th Leg. (Nev., May 7, 2007).

⁷ *Id.*

Ultimately, creditors may obtain a charging order to charge a debtor shareholder's interest in a corporation, but can only have the rights of an assignee, who only has a right to the shareholder's *economic* interest in the corporation.⁸

Stock that is exempt under NRS 21.090(1)(bb) can still be subject to a charging order pursuant to NRS 78.746(1).

NRS 21.090(1)(bb) exempts from bankruptcy “stock of a corporation described in subsection 2 of NRS 78.746 except as set forth in that section.” The debtor claimed, therefore, that only subsection 2 of NRS 78.746 applied to the bankruptcy exemption, and that if his corporation met the statutory requirements (i.e. less than 100 employees, closely-held, not professional) then his entire interest was exempt.

The court disagreed, finding that the phrase “except as set forth in that section” referred to all of NRS 78.746, not just subsection 2. Under subsection 1, a creditor can obtain a charging order to charge the debtor's corporate stock for payment of an unsatisfied debt, but the creditor is limited to the rights of an assignee. As an assignee, the creditor only has an economic interest in the corporation, and can attach a debtor's stream of income (i.e. distributions and dividends), but can neither take over management nor foreclose on shares.⁹ The debtor retains these non-economic interests.

NRS 78.746(2)(b) does not prohibit charging orders on shares of stock..

NRS 78.746(2)(b) also states that a stockholder shall not be deprived of “any exemption applicable to the stockholder's stock.” The debtor further argued that limiting his exemption to his non-economic interest in the corporation deprived him the benefit of an allowable exemption.

The court disagreed, finding that this subsection simply clarified how a charging order is still subject to other bankruptcy exemptions, such as the so-called wildcard exemption.¹⁰ Any other reading of NRS 78.746(2)(b) would render the charging order remedy under subsection 1 meaningless.

Conclusion

NRS 21.090(1)(bb) does not provide a complete exemption of corporate stock for small, non-public corporations because it is limited by all of NRS 78.746, not just subsection 2. Despite the allowable exemption, NRS 78.746(1) still subjects the debtor's economic interest to a charging order, while subsection 3 allows the debtor to retain his non-economic interest.

⁸ NEV. REV. STAT. § 78.746(1), (3).

⁹ NEV. REV. STAT. §78.746(3).

¹⁰ NEV. REV. STAT. §21.090(1)(z).