



Bankruptcy Basics

Handout

BANKRUPTCY BASICS

The fundamental goal of the federal bankruptcy laws enacted by Congress is to give debtors a financial "fresh start" from burdensome debts.

"[I]t gives to the honest but unfortunate debtor...a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."

THE ESTATE: The filing of the petition creates an "estate." The estate is the "temporary legal owner" of all the debtor's property and consists of all legal or equitable interests of the debtor in property.

AUTOMATIC STAY: An injunction that automatically stops lawsuits, foreclosures, garnishments, and all collection activity against the debtor the moment a bankruptcy petition is filed. The stay arises by operation of law and requires no judicial action. As long as the stay is in effect, creditors generally may not initiate or continue lawsuits, wage garnishments, or even telephone calls demanding payments.

SERVICEMEMBERS' CIVIL RELIEF ACT

This Act temporarily suspends judicial proceedings, including bankruptcy proceedings, that may adversely affect servicemembers during their military service. The protections generally end within 90 days of discharge. Portions of the SCRA also apply to reservists and inductees who have received orders but not yet reported to active duty or induction into the military service.

TYPES OF BANKRUPTCY PROCEEDINGS

There are 6 basic types of bankruptcy cases are provided for under the Bankruptcy Code and are referred to by the Chapter that describes them.

There is a bankruptcy court for each judicial district in the country. Each state has one or more districts. There are 90 bankruptcy districts across the country.

Access to Information

PACER – Public Access to Court Electronic Records is an electronic public access service that allows users to obtain case and docket information from Bankruptcy courts. Each court maintains their own database with case information. It is inexpensive (\$0.08 per page), fast, and comprehensive information about cases via a computer over the internet.

The PACER System offers electronic access to case dockets to retrieve information such as:

- A listing of all parties and participants including judges, attorneys, and trustees
- A compilation of case related information such as cause of action, nature of suit, and dollar demand
- A chronology of dates of case events entered in the case record
- A claims registry
- A listing of new cases each day
- Appellate court opinions
- Judgments or case status
- Types of documents filed for certain cases
- Many courts offer imaged copies of documents

CHAPTER 7

Also known as **liquidation** is an orderly, court-supervised procedure by which a trustee takes over the assets of the debtor's estate, reduces them to cash, and makes distributions to creditors, subject to the debtor's right to retain certain exempt property and the rights of secured creditors. Part of the debtor's property may be subject to liens and mortgages that pledge the property to other creditors and the chapter 7 bankruptcy discharge does not extinguish a lien on property..

Role of the Case Trustee

The primary role of a chapter 7 trustee in an asset case is to liquidate the debtor's nonexempt assets in a manner that maximizes the return to the debtor's unsecured creditors. The trustee accomplishes this by selling the debtor's property if it is free and clear of liens (as long as the property is not exempt) or if it is worth more than any security interest or lien attached to the property and any exemption that the debtor holds in the property.

In most chapter 7 cases, the Debtors do not have any non-exempt assets hence the name "no-asset cases."

How Chapter 7 Works

1. **Petition** is filed. Filing a petition under chapter 7 "automatically stays" (stops) most collection actions against the debtor or the debtor's property.
2. 20 - 40 days after the petition is filed, the trustee will hold a **meeting of creditors** (341 Hearing). At this hearing, the debtor while under oath is questioned by both the trustee and creditors regarding his financial affairs and property. Bankruptcy judges are prohibited from attending the meeting of creditors.

No asset cases

3. If the Trustee does not find any assets, he will issue a **Trustee No Asset Report** (TNAR)
4. In most cases, the **discharge order** will be entered generally within 60 to 90 days after the date first set for the meeting of creditors.
5. Typical No Asset Case lasts about 120 days
 - a. In the typical no asset chapter 7 case, there is no need for creditors to file proofs of claim because there will be no distribution.
 - b. To start or resume foreclosure or eviction proceedings, a MFR is needed
 - c. Should payments received during the bankruptcy be applied?
 - ii) Business decision made knowing about effect it could have on possible foreclosure actions and/or MFR

Asset cases

5. If the Trustee does find **assets**:
 - a. Case can last an indefinite period of time
 - b. To start or resume foreclosure or eviction proceedings, a MFR is needed
 - c. If the trustee later recovers assets for distribution to unsecured creditors, the Bankruptcy Court will issue a **notice to file claims**. Generally a secured creditor does not need to file a proof of claim in a chapter 7 case unless the trustee is liquidating the property on which you hold a security interest or lien. There may be other reasons to file a claim. You should consult your local counsel for advice.

Problems

6. Very active Trustee Panel: if there is a defect in the mortgage, they will generally uncover it and take action
 - a. **Motions to Sell:** terms to watch out for “surcharge” or “impair lien.” Generally, the Trustee must be given a reasonable time to sell the property.
 - b. **Adversaries:** The trustee may also attempt to recover money or property under the trustee's "avoiding powers" which include the power to: set aside preferential transfers and undo security interests and other prepetition transfers of property that were not properly perfected under nonbankruptcy law at the time of the petition.

Termination of the Stay

7. When is the automatic stay terminated?
 - a. A creditor may file a motion with the court seeking relief from the automatic stay where there is not sufficient equity in the collateral to justify maintaining the asset as part of the estate.
 - b. In some jurisdictions, the Creditor may wait out the administration of the case until such time as the court has entered one of the following combination of notices/orders:
 - i. Stay terminates when the TNAR and Discharge entered
 - ii. Trustee abandonment of the asset and Discharge entered
 - iii. Trustee final report in asset case and Discharge entered

The Chapter 7 Discharge

A discharge releases individual debtors from personal liability for most debts and permanently prevents the creditors owed those debts from initiating or continuing any legal or other action against the debtor to collect a discharged debt.

Where a creditor holds a properly perfected secured lien prior to the filing, the lien passes through the bankruptcy unaffected and only the personal obligation to pay (i.e., the note) is eliminated. Therefore, secured creditors are free, after the bankruptcy is concluded or relief from stay granted, to pursue its state law rights as to the property. However, Creditors must be very careful not to demand payment since the personal obligation has been extinguished. Great pains should be made to carefully word all correspondence to customers who have obtained a chapter 7 discharge. A discharge does not relieve a non-filing co-debtor from the obligation to pay.

Voluntary payments made by debtors to keep the property may be accepted whether or not a reaffirmation exists.

Reaffirmation

Some debtors may express a desire to "reaffirm" a debt. A reaffirmation is an agreement between the debtor and the creditor that the debtor will remain liable and will pay all or a portion of the money owed, even though the debt would otherwise be discharged in the bankruptcy.

If the debtor decides to reaffirm a debt, he or she must sign a written reaffirmation agreement and file it with the court before the discharge order is entered.

The Bankruptcy Code requires that reaffirmation agreements contain an extensive set of disclosures and may require approval by the bankruptcy judge.

CHAPTER 13

Often called a wage earner's plan and is designed for an individual debtor who has a regular source of income or is used by those who do not qualify for chapter 7 relief. The primary advantage that Chapter 13 offers individuals over liquidation under chapter 7 is the opportunity to save their home from foreclosure by curing delinquent mortgage payments over time – usually three to five years.

A chapter 13 debtor remains in possession of the property of the estate and makes payments to creditors through the trustee. To receive a chapter 13 discharge, the debtor must complete the payments required under the plan and during the life of the plan, the law forbids creditors from starting or continuing collection efforts.

Chapter 13 also has a special provision that protects third parties who are liable with the debtor on "consumer debts" also known as the non-filing co-debtor.

How Chapter 13 Works

1. **Petition** is filed.
 - a. In most cases, the *automatic stay* comes into effect and stops most collection actions against the debtor or the debtor's property.
 - b. Chapter 13 also contains a special automatic stay provision that protects *non-filing co-debtors* and a creditor may not seek to collect a "consumer debt" (debts incurred for personal, family, or household purpose) from any individual who is liable along with the debtor.
2. Within 30 days after filing the bankruptcy case, the debtor must start making **plan payments** to the trustee.
3. Generally, the debtor's **plan** must be filed with the petition or within 15 days after the petition is filed. A plan must be submitted for court approval and must provide for payments of fixed amounts to the trustee on a regular basis, weekly, biweekly, semi-monthly or monthly.

Hearings

4. 20 and 50 days after the debtor files the chapter 13 petition, the chapter 13 trustee will hold a meeting of creditors (**341 Hearing**).
 - a. The debtor testifies while under oath regarding his financial affairs and property.

- b. Bankruptcy judges are prohibited from attending the meeting of creditors.
 - c. In some states, confirmation can occur at the 341 hearing.
 - d. High volume of cases – approximately 20 cases per hour (3 minutes per case) are pushed through the systems at a 341 meeting.
5. No later than 45 days after the meeting of creditors, the bankruptcy judge must hold a **confirmation hearing** and decide whether the plan is feasible and meets the standards for confirmation set forth in the Bankruptcy Code.
- a. Creditors will receive 25 days' notice of the hearing and may object to confirmation. The debtor, the chapter 13 trustee, and those creditors who wish to attend will come to court for the hearing.
 - i. The provisions of a confirmed plan bind the debtor and each creditor.
 - ii. The Trustee does not disburse funds until confirmation of the case, unless it is a district that allows adequate protection orders (APO).
 - iii. Attendance is necessary to ensure: objections to plan are heard and payment compliance is sufficient

Objections to Confirmation

- a. Proposed modification of the mortgage
- b. Unreasonable cure time of arrearages
- c. No treatment, underfunding, understated arrears
- d. No provisions for taxes and/or insurance
- e. Sale of property with no time frame
- f. Precludes or limits the filing of a deficiency claim
- g. Cramdown or attempts to avoid the mortgage
- h. Unusual circumstances – no title interest in property
- i. Valid pre-petition foreclosure sale
- j. Serial or abusive filer

Proofs of Claim

6. In a chapter 13 case, to participate in distributions from the bankruptcy estate, creditors must file their claims with the court within 90 days after the first date set for the meeting of creditors.
- a. 1 form – 2 attachments (Total Debt and arrears)
 - b. Documents: recorded mortgage (all pages), recorded assignments and note
 - c. Need to file and also serve on court, Trustee, Debtor's attorney (ECF)
 - d. Can be included (varies by district):
 - i. Pre-petition: Late charges, inspection fees, escrow shortages/advances, attorney fees & costs for foreclosure and/or prior bankruptcies, missed payments up until the date of filing.
 - e. Can't be included:
 - i. Fax fees, breach fees, title indemnification, title claims, preparation of assignments, required certified mail, service transfers, adequate protection orders, escrow change letters, fax fees, fed ex fees, obtaining document costs, payoff statement charges.

Failure to Confirm

7. If the court declines to confirm the plan, the debtor may:
 - a. file a modified plan
 - b. convert the case to a chapter 7
 - c. dismiss the case - the court may authorize the trustee to keep some funds for costs, but the trustee must return all remaining funds to the debtor (other than funds already disbursed or due to creditors).

During the life of the Case

8. Pre-petition and Post-Petition payments
 - a. In some states, the Chapter 13 Trustee makes all payments both post-petition on-going payments and pre-petition arrears. In other states the trustee may only pay the arrears.
 - b. First payment from the Trustee in conduit states is approximately 30-60 days after confirmation
 - c. Some Trustees calculate arrears through confirmation rather than petition date - need to be aware if you do your own claims
9. Escrow analyses and Application of Payments
 - a. Escrowed loans should be analyzed "as if current" immediately upon filing. The new mortgage payment for the first post-petition month should be noted in the claim as well as escrow shortages.
 - b. Must be analyzed on a yearly basis and notice of payment changes sent to Debtor, Debtor's attorney, and the Chapter 13 Trustee **prior** to the effective date. Failure to do so may result in loss of payment increases.
 - c. Not analyzing loans on a yearly basis leads to escrow shortages and/or payment increases that the Trustee is not notified of and thus, payments are generally being received at lower amount when payment is higher - loan not current at discharge and deprives borrower of fresh start intent.
 - d. Payments must be applied pursuant to the plan as confirmed. Failure to do so can result in sanctions by the Court.
10. Motions For Relief During the Case
 - a. Pre-confirmation referrals are generally infeasible
 - b. Generally feasible when Debtor is down 2 or more payments to the Ch 13 Trustee or creditor (where direct pay)
 - e. Generally, payments must be accepted until the stay is terminated
 - f. Common result of MFRs are agreed orders – where the debtor has a feasible solution to the default that falls within acceptable parameters (cure over 6-12 months)
 - i. Can recover attorney fees
 - ii. Can get a future default provision

Extraordinary Relief

- a. Need to review each case individually
- b. In Rem vs. 180 day bar
 - i. In rem - still very serious and usually only granted for fraud
 - ii. 180 day bars are granted – usually three or more filings
 - iii. Dismissal with prejudice
- c. Fraud - partial transfers of real property

The Chapter 13 Discharge

As a general rule, the discharge releases the debtor from all debts provided for by the plan or disallowed, with the exception of certain debts like certain long term obligations (such as a home mortgage).

Effect of Ch 13 Discharge Orders

In some jurisdictions, there are local rules that loans are deemed current upon discharge including all payments, escrow balances, late charges, and fees/costs. Other districts are starting to implement this via motions to deem current.

BANKRUPTCY EFFECTS ON FORECLOSURE SALE THAT HAS BEEN HELD

Valid Sale – If the bankruptcy is filed after the foreclosure sale is validly held, the sale generally remains valid despite the bankruptcy. However, if the mortgagor files a chapter 13, we must immediately file a motion for relief (MFR) from the automatic stay and/or objections to confirmation of the case. Should the Creditor fail to take immediate action, it might be interpreted as consent to treatment under the plan.

Validate – If the bankruptcy is filed before the foreclosure sale is validly held, there are times where a Creditor may seek to validate the sale. Instances where that approach may be taken include:

1. Property not listed on schedules/matrix/plan
2. Multiple filings
3. Vacant/surrender/abandoned
4. Fraud

Glossary of Terms

A

abandonment the act of a trustee to remove from property of the estate assets that are burdensome or of inconsequential value to the estate. A common example is an asset with no equity.

adversary proceeding A lawsuit arising in or related to a bankruptcy case that is commenced by filing a complaint with the court.

automatic stay An injunction that automatically stops lawsuits, foreclosures, garnishments, and all collection activity against the debtor the moment a bankruptcy petition is filed.

B

bankruptcy A legal procedure for dealing with debt problems of individuals and businesses; specifically, a case filed under one of the chapters of title 11 of the United States Code (the Bankruptcy Code).

Bankruptcy Code The informal name for title 11 of the United States Code (11 U.S.C. §§ 101-1330), the federal bankruptcy law.

bankruptcy estate All legal or equitable interests of the debtor in property at the time of the bankruptcy filing. (The estate includes all property in which the debtor has an interest, even if it is owned or held by another person.)

bankruptcy petition The document filed by the debtor (in a voluntary case) or by creditors (in an involuntary case) by which opens the bankruptcy case. (There are official forms for bankruptcy petitions.)

C

chapter 7 The chapter of the Bankruptcy Code providing for "liquidation," (*i.e.*, the sale of a debtor's nonexempt property and the distribution of the proceeds to creditors.)

chapter 13 The chapter of the Bankruptcy Code providing for adjustment of debts of an individual with regular income. (Chapter 13 allows a debtor to keep property and pay debts over time, usually three to five years.)

claim A creditor's assertion of a right to payment of any kind from the debtor or the debtor's property. Creditors file claims reflecting the debt owed to them. A claim may be either secured or unsecured.

claims bar date a deadline set by each individual bankruptcy district court for creditors to file claims stating what they are owed. An untimely claim *may* not be paid.

collateral an interest in property or other rights held by a *secured* creditor to secure repayment of a debt

confirmation Bankruptcy judge's approval of a plan of reorganization in chapter 13.

consumer debts debts incurred by an individual primarily for a personal, family, or household purpose.

cramdown the act of allowing a secured creditor full payment of a debt only to the *value of the collateral*, with any debt above value paid as an unsecured claim

creditor One to whom the debtor owes money or who claims to be owed money by the debtor.

creditors' or 341 meeting The meeting of creditors required by section 341 of the Bankruptcy Code at which the debtor is questioned under oath by creditors, a trustee, examiner, or the U.S. trustee about his/her financial affairs.

D

debtor A person who has filed a petition for relief under the Bankruptcy Code.

discharge A release of a debtor from personal liability for certain dischargeable debts set forth in the Bankruptcy Code. (A discharge releases a debtor from personal liability for certain debts known as dischargeable debts and prevents the creditors owed those debts from taking any action against the debtor to collect the debts. The discharge also prohibits creditors from communicating with the debtor regarding the debt, including telephone calls, letters, and personal contact.)

dismissal the termination of a bankruptcy in a manner that restores the parties to their rights and liabilities as if the bankruptcy never existed

E

equity The value of a debtor's interest in property that remains after liens and other creditors' interests are considered. (Example: If a house valued at \$100,000 is subject to a \$80,000 mortgage, there is \$20,000 of equity.)

exemptions, exempt property Certain property owned by an individual debtor that the Bankruptcy Code or applicable state law permits the debtor to keep from unsecured creditors. For example, in some states the debtor may be able to exempt all or a portion of the equity in the debtor's primary residence (homestead exemption), or some or all "tools of the trade" used by the debtor to make a living (*i.e.*, auto tools for an auto mechanic or dental tools for a dentist). The availability and amount of property the debtor may exempt depends on the state the debtor lives in.

F

fraudulent transfer A transfer of a debtor's property made with intent to defraud or for which the debtor receives less than the transferred property's value.

I

J

joint petition One bankruptcy petition filed by a husband and wife together.

L

lien The right to take and hold or sell the property of a debtor as security or payment for a debt or duty.

lien stripping a process by which a debtor in a chapter 13 or a chapter 7 trustee may seek to “strip off” the lien of a secured creditor leaving that creditor completely unsecured. In a Chapter 13 this may in some jurisdictions be accomplished where there is no equity above the debt of a senior lien holder (and the junior is stripped). In a chapter 7 and chapter 13 the lien may be stripped where there is improper perfection (also called lien avoidance).

liquidation A sale of a debtor's property with the proceeds to be used for the benefit of creditors.

M

motion to lift the automatic stay A request by a creditor to allow the creditor to take action against the debtor or the debtor's property that would otherwise be prohibited by the automatic stay.

N

no-asset case A chapter 7 case where there are no assets available to satisfy any portion of the creditors' unsecured claims.

O

P

plan A debtor's detailed description of how the debtor proposes to pay creditors' claims over a fixed period of time.

postpetition transfer A transfer of the debtor's property made after the commencement of the case.

preference or preferential debt payment A debt payment made to a creditor in the 90-day period before a debtor files bankruptcy (or within one year if the creditor was an insider) that gives the creditor more than the creditor would receive in the debtor's chapter 7 case.

proof of claim A written statement and verifying documentation filed by a creditor that describes the reason the debtor owes the creditor money. (There is an official form for this purpose.)

property of the estate All legal or equitable interests of the debtor in property as of the commencement of the case.

R

reaffirmation agreement An agreement by a chapter 7 debtor to continue paying a dischargeable debt (such as an auto loan) after the bankruptcy, usually for the purpose of keeping collateral (*i.e.* the car) that would otherwise be subject to repossession.

S

sale free and clear of liens a sale generally proposed by the Trustee who seeks to sell property of the estate free of liens and over the objection of any lienholder. Liens may be transferred to sale proceeds.

secured creditor A creditor holding a claim against the debtor who has the right to take and hold or sell certain property of the debtor in satisfaction of some or all of the claim.

secured debt Debt backed by a mortgage, pledge of collateral, or other lien; debt for which the creditor has the right to pursue specific pledged property upon default. Examples include home mortgages, auto loans and tax liens.

schedules Detailed lists filed by the debtor along with (or shortly after filing) the petition showing the debtor's assets, liabilities, and other financial information. (There are official forms a debtor must use.)

statement of financial affairs A series of questions the debtor must answer in writing concerning sources of income, transfers of property, lawsuits by creditors, etc. (There is an official form a debtor must use.)

statement of intention A declaration made by a chapter 7 debtor concerning plans for dealing with consumer debts that are secured by property of the estate.

T

transfer Any mode or means by which a debtor disposes of or parts with his/her property.

trustee The representative of the bankruptcy estate who exercises statutory powers, principally for the benefit of the unsecured creditors, under the general supervision of the court and the direct supervision of the U.S. trustee or bankruptcy administrator.

U

unscheduled debt A debt that should have been listed by the debtor in the schedules filed with the court but was not. (Depending on the circumstances, an unscheduled debt may or may not be discharged.)

unsecured claim A claim or debt for which a creditor holds no special assurance of payment, such as a mortgage or lien; a debt for which credit was extended based solely upon the creditor's assessment of the debtor's future ability to pay.