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## **BANKRUPTCY 101**

### **ALRP Seminar – October 12, 2023**

**Types of Bankruptcies** - The Bankruptcy Code is found at 11 USC §101 et seq.

**Chapter 7:** liquidation - for individuals, partnerships, corporations (11 USC §701 et seq.)

- No required amount of assets or liabilities.
- Debtor has limited non-exempt assets to protect.
- Consumer debtors must pass the “means test” to determine eligibility. This calculates whether the debtor has the financial means to pay their debts. Debtors are exempt from the means test if more than 50% of their debt is not consumer debt (ie: mortgage, business).
- Debtor is entitled to exempt certain property in Chapter 7.
- A trustee is appointed. In asset cases, the trustee distributes non-exempt assets to creditors in order of priority/pro-rata basis (administrative, secured, unsecured).
- A business debtor closes its doors and the trustee takes over control. The trustee liquidates any equipment and inventory of value.
- Most individual no asset chapter 7 cases are completed and discharge of personal liability is entered in about 4 months from the filing; debt must be included in the bankruptcy schedules to be discharged.
- Secured debt is not discharged. Most taxes, student loans and domestic support obligations are also not dischargeable.
- Individuals are not eligible for Chapter 7 if they received a discharge in the past 8 years, or if a Chapter 7 or 13 in the previous 180 days was dismissed because they failed to comply with court orders, or if they voluntarily dismissed their own filing after a creditor sought relief from stay.

**Chapter 13:** for individuals and sole proprietors with regular income and total secured and unsecured debt of less than \$2,750,000. Corporations are not eligible for Chapter 13. 11 USC §1301 et seq.

- Protects debtor’s assets.
- Debtor enters into a payment plan to pay a percentage of future income (3-5 yrs.

depending on income); Trustee distributes funds to creditors pursuant to Chapter 13 Plan.

- Chapter 13 creates a stay for co-debtors on consumer debts.
- Recent laws have provided for a pathway toward discharge or modification of student loans
- Debtors must not have filed for Chapter 13 in the past two years or Chapter 7 bankruptcy in the past four years; Debtors must be current or get current on tax filings quickly.

**Chapter 9:** Municipalities. 11 USC §901 et seq..

**Chapter 11:** Reorganization – traditionally for corporations and partnerships; now also available for individuals, especially in California where secured debt is high due to high real estate values.

- Debtor is generally a Debtor in Possession. No required liquidation of Estate assets.
- Business Debtor stays in business and/or sells its assets in an orderly fashion.
- Plan must be accepted by creditors and confirmed by the Court. 11 USC §1101 et seq..

**Subchapter V:** expedited, simpler and less expensive than the traditional Chapter 11, for debtors with total debts less than \$7.5 million.

- To be eligible, debtor (whether an entity or an individual) must be engaged in commercial activity; at least half of the debts must have come from business activity.
- Trustee oversees the case.

**Chapter 12:** family farmers and fisherman with regular annual income – Plan for 3 / 5 years. 11 USC §1201 et seq..

**Chapter 15:** Cross-border cases 11 USC §1501

### **A Few Miscellaneous Principles and Advantages of Bankruptcy**

- A fresh start: relieves a debtor of financial burden.
- Generally, bankruptcy cases go more quickly than other federal or state court cases. Motions are heard and decided faster. The same judge is assigned for the entire proceeding. In most consumer chapter 7 cases, you and the debtor never see a judge.
- Bankruptcy judges can resolve any matters, not just financial.
- Although bankruptcy law is federal, it looks to state law for certain issues, such as exemptions.
- The automatic stay enjoins any action *against* the debtor or its property, but not actions *by* the Debtor (11 USC §362). Notify the creditor of the bankruptcy filing in the case of any immediate threat (ie: foreclosure).
- The bankruptcy discharge is for “honest debtors”; the case must be filed in good faith – the fraud exception precludes a discharge 11 USC §523

## **Procedure**

When discussing a potential bankruptcy filing with the client, thoroughly review all financial information, including all assets, liabilities, recent sales or transfers of assets, co-debtors, etc.

Consumer debtors must take a pre-filing credit counseling course and pre-discharge financial management course.

### **PETITION - SLIDE #1**

Any case is initiated by the filing of the Petition, Schedules and Statement of Financial Affairs: this provides complete details of the debtor's financial situation as of the date of filing.

The Voluntary Petition provides the debtor's basic information. In any emergency filing the Petition is the only document filed and the rest must be filed within 14 days.

- The Summary of Schedules is generated from the information provided in Schedules A-J.
- A/B is the Real and Personal Property Schedule
- C is the exemption schedule. California bankruptcy exemptions allow debtors to keep certain property that would otherwise be sold to pay creditors. Debtors choose between two different sets of exemptions, under CCP §703 and CCP §704.

### **CALIFORNIA EXEMPTION SCHEDULES - SLIDE #2 -**

- A homeowner generally chooses CCP §704 exemptions, as they can now exempt \$678,391 in equity in a home, depending on the County of residence.
- CCP §703 provides a "wildcard exemption" - currently \$30,825 - to be used on top of other delineated exemptions (ie: cars: \$7,500 and tools of the trade \$9,525 under both schemes; Household goods are exempt under both schemes)
- Schedules D and E/F: Secured and unsecured creditors.
- Schedule G: Executory contracts and unexpired leases.
- Schedule H: Co-debtors (subject to a stay in Chapter 13, if a consumer debt).
- Schedules I and J: Income and Expenses - if income is significantly higher than expenses, it could signal conversion to chapter 13; consider if income or expenses will be increasing or decreasing for chapter 7 eligibility
- Statement of Financial Affairs: includes details of certain assets and liabilities, employment, transfers, etc. prior to the filing.
- Statement Pursuant to Rule 2016(B) discloses attorney compensation. Fees are paid before a Chapter 7 is filed; there are no set fees. In Chapter 13, different districts and different trustees have their own Fee Guidelines. Be sure to check local guidelines.
- Statement of Current Monthly Income for Chapter 7 debtors: Income calculations are based on the 6 months prior to filing, so bonuses or extra income should be considered in deciding when to file. Social security benefits are not considered income for the means test. If income is over the median income, expenses are taken into consideration.

- 11 USC 342(b) Notice advises individual debtors of general bankruptcy information and required filing fees
- The Creditor Matrix is generated from entry of other data and is used by the Court to notify creditors and interested parties.

### **Notice of Bankruptcy - SLIDE #3**

Once the case is filed, the Court mails the Notice of Bankruptcy to all scheduled creditors, and provides notice of the filing, the date for the Meeting of Creditors (generally about 1 month from the filing), and the last date to object to discharge.

### **From a Creditor's Perspective:**

- The automatic stay is in effect, as soon as the case is filed even if the creditor hasn't received actual notice.
- Creditor may file a Motion for Relief from Stay to proceed with foreclosure, eviction, or to pursue litigation in another court. Relief from stay is appropriate for "cause" or if the property isn't necessary for an effective reorganization of debtor's estate 11 USC §362(d).
- If there have been multiple bankruptcies and the debtor is not eligible to file the current case, get a "comfort order" to assure you're not violating the stay.

**Proof of Claim - SLIDE #4** File a Proof of Claim by the bar date on the Notice of Bankruptcy even if the debtor has accurately scheduled the debt.

**Preferences:** 11 USC §547. A trustee (or DIP) may avoid a transfer of an interest of the debtor in property:

- To or for the benefit of a creditor; for or on account of an antecedent debt; made while the debtor was insolvent;
- Within 90 days before the date of the filing of the petition, or one year before the date of the filing of the petition, if such creditor was an insider;
- And that enables the creditor to receive more than it would receive if the case were a case under chapter 7 and the transfer had not been made.

### **Defenses to Preference Action:**

- The transfer was intended by the debtor and the creditor to be a contemporaneous exchange for new value given to the debtor; and was a substantially contemporaneous exchange; or
- The transfer was made in the ordinary course of business or financial affairs of the debtor and the transferee.

### **A FEW USEFUL RESOURCES:**

United States Bankruptcy Code (11 U.S.C. §101 et seq.)  
Federal Rules of Bankruptcy Procedure  
U.S. Bankruptcy Court Website  
Local Rules / Individual Judge's Procedures  
California Statutes (especially CCP §§703 and 704 re exemptions)  
National Association of Consumer Bankruptcy Attorneys (NACBA)  
American Bankruptcy Institute (ABI)  
Bankruptcy preparation software

### **SEMINAR MATERIALS**

1. Voluntary Bankruptcy Petition, Schedules and Statement of Financial Affairs
2. Notice of Bankruptcy
3. Exemption Schedules
4. Proof of Claim form
5. Bay Area Bankruptcy Forum Annual Judge's Panel 9/6/23 materials re New DOJ/DOE Guidelines for §523(a)(8) Proceedings - (Student Loans)

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