

# Bankruptcy **BASICS**

Leonidas Ralph Mecham, Director

Administrative Office  
of the United States Courts

# Bankruptcy BASICS

## *A Public Information Series of the Bankruptcy Judges Division*

### THE PAMPHLET

The Bankruptcy Judges Division's Public Information Series pamphlet provides basic information to debtors, creditors, court personnel, the media, and the general public on different aspects of the federal bankruptcy laws. The series is also designed to provide individuals who may be considering bankruptcy with a basic explanation of the different chapters under which a bankruptcy case may be filed and to answer some of the most commonly asked questions about the bankruptcy process.

This pamphlet provides general information only. While every effort has been made to ensure that the information contained in it is accurate as of the date of publication, it is not a full and authoritative statement of the law on any particular topic. The information presented in the pamphlet should not be cited or relied upon as legal authority and should not be used as a substitute for reference to the United States Bankruptcy Code (title 11, United States Code) and the Federal Rules of Bankruptcy Procedure.

Most importantly, the pamphlet should not substitute for the advice of

competent legal counsel or a financial expert. Neither the Bankruptcy Judges Division nor the Administrative Office of the United States Courts can provide legal or financial advice. Such advice may be obtained from a competent attorney, accountant, or financial adviser.

### THE PROCESS

Article I, Section 8, of the United States Constitution authorizes Congress to enact "uniform Laws on the subject of Bankruptcies." Under this grant of authority, Congress enacted the "Bankruptcy Code" in 1978. The Code, which is codified as title 11 of the United States Code, has been amended several times since its enactment. It is the uniform federal law that governs all bankruptcy cases.

The procedural aspects of the bankruptcy process are governed by the Federal Rules of Bankruptcy Procedure (often called the "Bankruptcy Rules") and local rules of bankruptcy. The Bankruptcy Rules contain a set of official forms for use in bankruptcy cases. The Bankruptcy Code and Bankruptcy Rules (and local rules) set forth the formal legal

procedures for dealing with the debt problems of individuals and businesses.

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. The bankruptcy courts generally have their own clerk's offices.

The court official with decision-making power over federal bankruptcy cases is the United States bankruptcy judge, a judicial officer of the United States district court.

The court official with decision-making power over federal bankruptcy cases is the United States bankruptcy judge, a judicial officer of the United States district court. The bankruptcy judge may decide any matter connected with a bankruptcy case, such as eligibility to file or whether a debtor should receive a discharge of debts. Much of the bankruptcy process is administrative, however, and is conducted away from the courthouse. In cases under chapter 7, 12, or 13, and sometimes in chapter 11 cases, this administrative

process is carried out by a trustee who is appointed to oversee the case.

A debtor's involvement with the bankruptcy judge is usually very limited. A typical chapter 7 debtor will not appear in court and will not see the bankruptcy judge unless an objection is raised in the case. A chapter 13 debtor may only have to appear before the bankruptcy judge at a plan confirmation hearing. Usually, the only formal proceeding at which a debtor must appear is the meeting of creditors, which is usually held at the offices of the United States trustee. This meeting is informally called a "341 meeting" because section 341 of the Bankruptcy Code requires that the debtor attend this meeting so that creditors can question the debtor about debts and property.

A fundamental goal of the federal bankruptcy laws enacted by Congress is to give debtors a financial "fresh start" from burdensome debts. The Supreme Court made this point about the purpose of the bankruptcy law in a 1934 decision:

[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.

*Local Loan v. Hunt, 292 U.S. 234, 244 (1934)*. This goal is accomplished through the bankruptcy discharge, which releases debtors from personal liability from specific debts and prohibits creditors from ever taking any action against the debtor to collect those debts. This pamphlet describes the **Discharge in Bankruptcy** in a question and answer format, discussing the

timing of the discharge, the scope of the discharge (what debts are discharged and what debts are not discharged), objections to discharge, and revocation of the discharge. It also describes what a debtor can do if a creditor attempts to collect a discharged debt after the bankruptcy case is concluded.

There are five basic types of bankruptcy cases provided for under the Bankruptcy Code, each of which is discussed in this pamphlet. The cases are traditionally given the names of the chapters that describe them.

Chapter 7, entitled **Liquidation**, contemplates an orderly, court-supervised procedure by which a trustee collects 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. Because there is usually little or no nonexempt property in most chapter 7 cases, there may not be an actual liquidation of the debtor's assets. These cases are called "no-asset cases." A creditor holding an unsecured claim will get a distribution from the bankruptcy estate only if the case is an asset case and the creditor files a proof of claim with the bankruptcy court. In most chapter 7 cases, the debtor receives a discharge that releases the debtor from personal liability for certain dischargeable debts. The debtor normally receives a discharge just a few months after the petition is filed.

Chapter 13, entitled **Adjustment of Debts of an Individual With Regular Income**, is designed for an individual debtor who has a regular source of income. Chapter 13 is often preferable to chapter 7 because it enables the debtor to keep a valuable asset, such as

a house. It is also favored because it allows the debtor to propose a "plan" to repay creditors over time—usually three to five years. At a confirmation hearing, the court either approves or disapproves the plan, depending on whether the plan meets the Bankruptcy Code's requirements for confirmation. Chapter 13 is very different from chapter 7, since the chapter 13 debtor usually remains in possession of the property of the estate and makes payments to creditors, through the trustee, based on the debtor's anticipated income over the life of the plan. Unlike chapter 7, the debtor does not receive an immediate discharge of debts. The debtor must complete the payments required under the plan before the discharge is received. The debtor is protected from lawsuits, garnishments, and other creditor action while the plan is in effect. The discharge is also considerably broader (i.e., more debts are eliminated) under chapter 13 than the discharge under chapter 7.

Chapter 11, entitled **Reorganization**, ordinarily is used by commercial enterprises that desire to continue operating a business and repay creditors concurrently through a court-approved plan of reorganization. The chapter 11 debtor has the exclusive right to file a plan of reorganization for the first 120 days after the order for relief and must provide creditors with a disclosure statement containing information adequate to enable creditors to evaluate the plan. The court ultimately approves (confirms) or disapproves the plan of reorganization. Under the confirmed plan, the debtor can reduce its debts by repaying a portion of its obligations and discharging others. The debtor can also terminate burdensome contracts and

leases, recover assets, and rescale its operations in order to return to profitability. Under chapter 11, the debtor normally goes through a period of consolidation and emerges with a reduced debt load and a reorganized business.

Chapter 12, entitled **Adjustment of Debts of a Family Farmer with Regular Annual Income**, provides debt relief to family farmers with regular annual income. The process under chapter 12 is very similar to that of chapter 13 under which the debtor proposes a plan to repay debts over a period of time—no more than three years unless the court approves a longer period, not exceeding five years. There is also a trustee in every chapter 12 case whose duties are very similar to those of a chapter 13 trustee. The chapter 12 trustee's disbursement of payments to creditors under a confirmed plan parallels the procedure under chapter 13. Chapter 12 allows a family farmer to continue to operate the farm while the plan is being carried out.

Chapter 9, entitled **Adjustment of Debts of a Municipality**, provides essentially for reorganization, much like a reorganization under chapter 11. Only a "municipality" may file under chapter 9, which includes cities and towns, as well as villages, counties, taxing districts, municipal utilities, and school districts.

This pamphlet also contains a description of liquidation proceedings under the **Securities Investor Protection Act**. Although the Bankruptcy Code provides for a stockbroker liquidation proceeding, it is far more likely that a failing brokerage firm will find itself involved in a SIPA proceeding. The purpose of SIPA is to return to investors securities and cash left with failed brokerages.

Since being established by Congress in 1970, the Securities Investor Protection Corporation has protected investors who deposit stocks and bonds with brokerage firms by ensuring that every customer's property is protected, up to \$500,000 per customer.

The bankruptcy process is complex and relies on legal concepts like the "automatic stay," "discharge," "exemptions," and "substantial abuse." Therefore, the final chapter of this booklet is a glossary of **Bankruptcy Terminology** which explains, in layman's terms, most of the legal concepts that apply in cases filed under the Bankruptcy Code.

# The Discharge in Bankruptcy

The bankruptcy discharge varies depending on the type of case a debtor files: chapter 7, 11, 12, or 13. This Public Information Series pamphlet attempts to answer some basic questions about the discharge available to individual debtors under all four chapters including:

1. What is a discharge in bankruptcy?
2. When does the discharge occur?
3. How does the debtor get a discharge?
4. Are all the debtor's debts discharged or only some?
5. Does the debtor have a right to a discharge or can creditors object to the discharge?
6. Can the debtor receive a second discharge in a later chapter 7 case?
7. Can the discharge be revoked?
8. May the debtor pay a discharged debt after the bankruptcy case has been concluded?
9. What can the debtor do if a creditor attempts to collect a discharged debt after the case is concluded?
10. May an employer terminate a debtor's employment solely because the person was a debtor or failed to repay a discharged debt?

# DISCHARGE

From an individual debtor's standpoint, one of the primary goals of filing a bankruptcy case is to obtain relief from burdensome debt. Relief is attained through the bankruptcy discharge, the purpose of which is to provide a "fresh start" to the honest debtor.

## WHAT IS A DISCHARGE IN BANKRUPTCY?

Under the federal bankruptcy statute, a discharge is a release of the debtor from personal liability for certain specified types of debts. In other words, the debtor is no longer required by law to pay any debts that are discharged. The discharge operates as a permanent order directed to the creditors of the debtor that they refrain from taking any form of collection action on discharged debts, including legal action and communications with the debtor, such as telephone calls, letters, and personal contacts.

Although a debtor is relieved of personal liability for all debts that are discharged, a valid lien (i.e., a charge upon specific property to secure payment of a debt) that has not been avoided (i.e., made unenforceable) in the bankruptcy case will remain after the bankruptcy case. Therefore, a secured creditor may enforce the lien to recover the property secured by the lien.

## WHEN DOES THE DISCHARGE OCCUR?

The timing of the discharge varies, depending on the chapter under which the case is filed. In a chapter 7 (liquidation) case, for example, the court usually grants the discharge promptly on expiration of the time fixed for filing a complaint objecting to discharge and the time fixed for filing a motion to dismiss the case for substantial abuse (60 days following the first date set for the 341 meeting). Typically, this occurs about four months after the date the debtor files the petition with the clerk of the bankruptcy court. In chapter 11 (reorganization) cases, the discharge occurs upon confirmation of a chapter

11 plan. In cases under chapter 12 (adjustment of debts of a family farmer) and 13 (adjustment of debts of an individual with regular income), the court grants the discharge as soon as practicable after the debtor completes all payments under the plan. Since a chapter 12 or chapter 13 plan may provide for payments to be made over three to five years, the discharge typically occurs about four years after the date of filing.

## HOW DOES THE DEBTOR GET A DISCHARGE?

Unless there is litigation involving objections to the discharge, the debtor will automatically receive a discharge. The Federal Rules of Bankruptcy Procedure provide for the clerk of the bankruptcy court to mail a copy of the order of discharge to all creditors, the United States trustee, the trustee in the case, and the trustee's attorney, if any. The debtor and the debtor's attorney also receive copies of the discharge order. The notice, which is simply a copy of the final order of discharge, is not specific as to those debts determined by the court to be non-dischargeable, i.e., not covered by the discharge. The notice informs creditors generally that the debts owed to them have been discharged and that they should not attempt any further collection. They are cautioned in the notice that continuing collection efforts could subject them to punishment for contempt. Any inadvertent failure on the part of the clerk to send the debtor or any creditor a copy of the discharge order promptly within the time required by the rules does not affect the validity of the order granting the discharge.

## ARE ALL OF THE DEBTOR'S DEBTS DISCHARGED OR ONLY SOME?

Not all debts are discharged. The debts discharged vary under each chapter of the Bankruptcy Code. Section 523(a) of the Code specifically excepts various categories of debts from the discharge granted to individual debtors. Therefore, the debtor must still repay those debts after bankruptcy. Congress has determined that these types of debts are not dischargeable for public policy reasons (based either on the nature of the debt or the fact that the debts were incurred due to improper behavior of the debtor, such as the debtor's drunken driving).

There are 18 categories of debt excepted from discharge under chapters 7, 11, and 12. A more limited list of exceptions applies to cases under chapter 13.

Generally speaking, the exceptions to discharge apply automatically if the language prescribed by section 523(a) applies. The most common types of non-dischargeable debts are certain types of tax claims, debts not set forth by the debtor on the lists and schedules the debtor must file with the court, debts for spousal or child support or alimony, debts for willful and malicious injuries to person or property, debts to governmental units for fines and penalties, debts for most government funded or guaranteed educational loans or benefit overpayments, debts for personal injury caused by the debtor's operation of a motor vehicle while intoxicated, and debts for certain condominium or cooperative housing fees.

The types of debts described in sections 523(a)(2), (4), (6), and (15) (obligations affected by fraud or maliciousness or certain debts incurred in connection with property settlements arising out of

Under the federal bankruptcy statute, a discharge is a release of the debtor from personal liability for certain specified types of debts. In other words, the debtor is no longer required by law to pay any debts that are discharged.

a separation agreement or divorce decree) are not automatically excepted from discharge. Creditors must ask the court to determine that these debts are excepted from discharge. In the absence of an affirmative request by the creditor and subsequent granting of the request by the court, the types of debts set out in sections 523(a)(2), (4), (6), and (15) will be discharged.

A broader discharge of debts is available to a debtor in a chapter 13 case than in a chapter 7 case. As a general rule, the chapter 13 debtor is discharged from all debts provided for by the plan except certain long-term obligations (such as a home mortgage), debts for alimony or child support, debts for most govern-

ment funded or guaranteed educational loans or benefit overpayments, debts arising from death or personal injury caused by driving while intoxicated or under the influence of drugs, and debts for restitution or a criminal fine included in a sentence on the debtor's conviction of a crime. Although a chapter 13 debtor

discharge is available only to a debtor whose failure to complete plan payments is due to circumstances beyond the debtor's control.

The scope of a chapter 13 "hardship discharge" is similar to that in a chapter 7 case with regard to the types of debts that are excepted from the discharge. A hardship discharge also is available in chapter 12 if the failure to complete plan payments is due to "circumstances for which the debtor should not justly be held accountable."

A governmental unit or private employer may not discriminate against a person solely because the person was a debtor, was insolvent before or during the case, or has not paid a debt that was discharged in the case.

generally receives a discharge only after completing all payments required by the court-approved (i.e., "confirmed") repayment plan, there are some limited circumstances under which the debtor may request the court to grant a "hardship discharge" even though the debtor has failed to complete plan payments. Such a

### DOES THE DEBTOR HAVE THE RIGHT TO A DISCHARGE OR CAN CREDITORS OBJECT TO THE DISCHARGE?

In chapter 7 cases, the debtor does not have an absolute right to a discharge. An objection to the debtor's discharge may be filed by a creditor, by the trustee in the case, or by the United States trustee. Creditors receive a notice shortly after the case is filed that sets forth much important information, including the deadline for objecting to the discharge. A creditor who desires to object to the debtor's discharge must do so by filing a complaint in the bankruptcy court before the deadline set out in the notice. Filing of a complaint starts a lawsuit referred to in bankruptcy as an "adversary proceeding." A chapter 7 discharge may be denied for any of the reasons described in section 727(a) of the Bankruptcy Code, including the transfer or concealment of property with intent to hinder, delay, or defraud creditors; destruction or concealment of books or records; perjury and other fraudulent acts; failure to account for the loss of assets; violation of a court order; or an earlier discharge in a chap-

ter 7 or 11 case commenced within six years before the date the petition was filed. If the issue of the debtor's right to a discharge goes to trial, the objecting party has the burden of proving all the facts essential to the objection.

In chapter 12 and chapter 13 cases, the debtor is entitled to a discharge upon completion of all payments under the plan. The Bankruptcy Code does not provide grounds for objecting to the discharge of a chapter 12 or chapter 13 debtor. Creditors can object to confirmation of the repayment plan, but cannot object to the discharge if the debtor has completed making plan payments.

### CAN A DEBTOR RECEIVE A SECOND DISCHARGE IN A LATER CHAPTER 7 CASE?

A discharge will be denied in a later chapter 7 case if the debtor has been granted a discharge under chapter 7 or chapter 11 in a case filed within six years before the second petition is filed. The debtor will also be denied a chapter 7 discharge if he or she previously was granted a discharge in a chapter 12 or chapter 13 case filed within six years before the date of the filing of the second case unless (1) all the "allowed unsecured" claims in the earlier case were paid in full, or (2) payments under the plan in the earlier case totaled at least 70 percent of the allowed unsecured claims and the debtor's plan was proposed in good faith and the payments represented the debtor's best effort.

### CAN THE DISCHARGE BE REVOKED?

A discharge can be revoked under certain circumstances. For instance, a trustee, creditor, or the United States trustee may request that the court revoke the debtor's

discharge in a chapter 7 case based on allegations that the debtor obtained the discharge fraudulently; the debtor failed to disclose the fact that he or she acquired or became entitled to acquire property that would constitute property of the bankruptcy estate; or the debtor committed one of several acts of impropriety described in section 727(a)(6) of the Bankruptcy Code. Typically, a request to revoke the debtor's discharge must be filed within one year after the granting of the discharge or, in some cases, before the date that the case is closed. It is up to the court to determine whether such allegations are true and, if so, to revoke the discharge.

In a chapter 13 case, if confirmation of a plan or the discharge is obtained through fraud, the court can revoke the order of confirmation or discharge.

### MAY THE DEBTOR PAY A DISCHARGED DEBT AFTER THE BANKRUPTCY CASE HAS BEEN CONCLUDED?

A debtor who has received a discharge may voluntarily repay any discharged debt. A debtor may repay a discharged debt even though it can no longer be legally enforced. Sometimes a debtor agrees to repay a debt because it is owed to a family member or because it represents an obligation to an individual for whom the debtor's reputation is important, such as a family doctor.

### WHAT CAN THE DEBTOR DO IF A CREDITOR ATTEMPTS TO COLLECT A DISCHARGED DEBT AFTER THE CASE IS CONCLUDED?

If a creditor attempts collection efforts on a discharged debt, the debtor can file a motion with the court, reporting

the action and asking that the case be reopened to address the matter. The bankruptcy court will often do so to ensure that the discharge is not violated. The discharge constitutes a permanent statutory injunction prohibiting creditors from taking any action, including the filing of a lawsuit, designed to collect a discharged debt. A creditor can be sanctioned by the court for violating the discharge injunction. The normal sanction for violating the discharge injunction is civil contempt, which is often punishable by a fine.

### CAN AN EMPLOYER TERMINATE A DEBTOR'S EMPLOYMENT SOLELY BECAUSE THE PERSON WAS A DEBTOR OR FAILED TO REPAY A DISCHARGED DEBT?

The law provides express prohibitions against discriminatory treatment of debtors by both governmental units and private employers. A governmental unit or private employer may not discriminate against a person solely because the person was a debtor, was insolvent before or during the case, or has not paid a debt that was discharged in the case. The law prohibits the following forms of governmental discrimination: terminating an employee; discriminating with respect to hiring; or denying, revoking, suspending, or declining to renew a license, franchise, or similar privilege. A private employer may not discriminate with respect to employment if the discrimination is based solely upon the bankruptcy filing.

# Liquidation Under the Bankruptcy Code

## ALTERNATIVES TO CHAPTER 7

Debtors should be aware that there are several alternatives to chapter 7 relief. For example, debtors who are engaged in business, including corporations, partnerships, and sole proprietorships, may prefer to remain in business and avoid liquidation. Such debtors should consider filing a petition under chapter 11 of the Bankruptcy Code. Under chapter 11, the debtor may seek an adjustment of debts, either by reducing the debt or by extending the time for repayment, or may seek a more comprehensive reorganization. Sole proprietorships may also be eligible for relief under chapter 13 of the Bankruptcy Code.

In addition, individual debtors who have regular income may seek an adjustment of debts under chapter 13 of the Bankruptcy Code. Indeed, the court may dismiss a chapter 7 case filed by an individual whose debts are primarily consumer rather than business debts if the court finds that the granting of relief would be a substantial abuse of the provisions of chapter 7. 11 U.S.C. § 707(b). A number of courts have concluded that a chapter 7 case may be dismissed for substantial abuse when the debtor has the ability to propose and carry out a workable and meaningful chapter 13 plan.

Debtors should also be aware that out-of-court agreements with creditors

Chapter 7 of the United States Bankruptcy Code is the Bankruptcy Code's "liquidation" chapter. Lawyers sometimes refer to it as a "straight bankruptcy." It is used primarily by individuals who wish to free themselves of debt simply and inexpensively, but may also be used by businesses that wish to liquidate and terminate their business.

or debt counseling services may provide an alternative to a bankruptcy filing.

## BACKGROUND

The potential chapter 7 debtor should understand that a straight bankruptcy case does not involve the filing of a plan of repayment as in chapter 13, but rather envisions the bankruptcy trustee's gathering and sale of the debtor's nonexempt assets, from which holders of claims (creditors) will receive distributions in accordance with the provisions of the Bankruptcy Code. Part of the debtor's property may be subject to liens and mortgages that pledge the property to other creditors. In addition, under chapter 7, the individual debtor is permitted to retain certain "exempt" property. The debtor's remaining assets are liquidated by a trustee. Accordingly, potential debtors should realize that the filing of a petition under chapter 7 may result in the loss of property.

In order to qualify for relief under chapter 7 of the Bankruptcy Code, the debtor must be an individual, a partnership, or a corporation. 11 U.S.C. §§ 109(b); 101(41). Relief is available under chapter 7 irrespective of the amount of the debtor's debts or whether the debtor is solvent or insolvent. An individual cannot file under chapter 7 or any other chapter, however, if during the preceding 180 days a prior bankruptcy petition was dismissed due to the debtor's willful failure to appear before the court or comply with orders of the court or the debtor voluntarily dismissed the previous case after creditors sought relief from the bankruptcy court to recover property upon which they hold liens. 11 U.S.C. §§ 109(g), 362(d) and (e).

One of the primary purposes of bankruptcy is to discharge certain debts to give an honest individual debtor a "fresh start." The discharge has the effect of extinguishing the debtor's personal liability on dischargeable debts. In a chapter 7 case, however, a discharge is available to individual debtors only, not to partnerships or corporations. 11 U.S.C. § 727(a)(1). Although the filing of an individual chapter 7 petition usually results in a discharge of debts, an individual's right to a discharge is not absolute, and some types of debts are not discharged. Moreover, a bankruptcy discharge does not extinguish a lien on property.

## HOW CHAPTER 7 WORKS

A chapter 7 case begins with the debtor's filing a petition with the bankruptcy court.<sup>1</sup> The petition should be filed with the bankruptcy court serving the area where the individual lives or where the business debtor has its principal place of business or principal assets. 28 U.S.C. § 1408. In addition to the petition, the debtor is also required to file with the court several schedules of assets and liabilities, a schedule of current income and expenditures, a statement of financial affairs, and a schedule of executory contracts and unexpired leases. Bankruptcy Rule 1007(b). A husband and wife may file a joint petition or individual petitions. 11 U.S.C. § 302(a). (Official Bankruptcy Forms can be purchased at a legal stationery store. They are not available from the court.)

In order to complete the Official Bankruptcy Forms which make up the petition and schedules, the debtor(s) will need to compile the following information:

1. A list of all creditors and the amount and nature of their claims;
2. The source, amount, and frequency of the debtor's income;
3. A list of all of the debtor's property; and
4. A detailed list of the debtor's monthly living expenses, i.e., food, clothing, shelter, utilities, taxes, transportation, medicine, etc.

Currently, the courts are required to charge a \$155 case filing fee, a \$39 miscellaneous administrative fee, and a \$15 trustee surcharge (a total of \$200). The fees should be paid to the clerk of the court upon filing or may, with the court's permission, be paid by individual debtors in installments. 28 U.S.C. § 1930(a); Bankruptcy Rule 1006(b); Bankruptcy Court Miscellaneous Fee Schedule, Item 8. Rule 1006(b) limits to four the number of installments for the filing fee. The final installment shall be payable not later than 120 days after filing the petition. For cause shown, the court may extend the time of any installment, provided that the last installment is paid not later than 180 days after the filing of the petition. Bankruptcy Rule 1006(b). The \$39 administrative fee and the \$15 trustee surcharge may be paid in installments in the same manner as the filing fee. If a joint petition is filed, only one filing fee, one administrative fee, and one trustee surcharge are charged. Debtors should be aware that failure to pay these fees may result in dismissal of the case. 11 U.S.C. § 707(a).

The filing of a petition under chapter 7 "automatically stays" most actions

against the debtor or the debtor's property. 11 U.S.C. § 362. This stay arises by operation of law and requires no judicial action. As long as the stay is in effect, creditors generally cannot initiate or continue any lawsuits, wage garnishments, or even telephone calls demanding payments. Creditors normally receive notice of the filing of the petition from the clerk.

One of the schedules that will be filed by the individual debtor is a schedule of "exempt" property. Federal bankruptcy law provides that an individual debtor<sup>2</sup> can protect some property from the claims of creditors either because it is exempt under federal bankruptcy law or because it is exempt under the laws of the debtor's home state. 11 U.S.C. § 522(b). Many states have taken advantage of a provision in the bankruptcy law that permits each state to adopt its own exemption law in place of the federal exemptions. In other jurisdictions, the individual debtor has the option of choosing between a federal package of exemptions or exemptions available under state law. Thus, whether certain property is exempt and may be kept by the debtor is often a question of state law. Legal counsel should be consulted to determine the law of the state in which the debtor lives.

A "meeting of creditors" is usually held 20 to 40 days after the petition is filed. If the United States trustee or bankruptcy administrator<sup>3</sup> designates a place for the meeting that is not regularly staffed by the United States trustee or bankruptcy administrator, the meeting may be held no more than 60 days after the order for relief. Bankruptcy Rule 2003(a). The debtor must attend this meeting, at which

creditors may appear and ask questions regarding the debtor's financial affairs and property. 11 U.S.C. § 343. If a husband and wife have filed a joint petition, they both must attend the creditors' meeting. The trustee also will attend this meeting. It is important for the debtor to cooperate with the trustee and to provide any financial records or documents that the trustee requests. The trustee is required to examine the debtor orally at the meeting of creditors to ensure that the debtor is aware of the potential consequences of seeking a discharge in bankruptcy, including the effect on credit history, the ability to file a petition under a different chapter, the effect of receiving a discharge, and the effect of reaffirming a debt. In some courts, trustees may provide written information on these topics at or in advance of the meeting, to ensure that the debtor is aware of this information. In order to preserve their independent judgment, bankruptcy judges are prohibited from attending the meeting of creditors. 11 U.S.C. § 341(c).

In order to accord the debtor complete relief, the Bankruptcy Code allows the debtor to convert a chapter 7 case to either a chapter 11 reorganization case or a case under chapter 13,<sup>4</sup> as long as the debtor meets the eligibility standards under the chapter to which the debtor seeks to convert, and the case has not previously been converted to chapter 7 from either chapter 11 or chapter 13. Thus, the debtor will not be permitted to convert the case repeatedly from one chapter to another. 11 U.S.C. § 706(a).

## ROLE OF THE CASE TRUSTEE

Upon the filing of the chapter 7 petition, an impartial case trustee is appointed by

the United States trustee (or by the court in Alabama and North Carolina) to administer the case and liquidate the debtor's nonexempt assets. 11 U.S.C. §§ 701, 704. If, as is often the case, all of the debtor's assets are exempt or subject to valid liens, there will be no distribution to unsecured creditors. Typically, most chapter 7 cases involving individual debtors are "no asset" cases. If the case appears to be an "asset" case at the outset, however, unsecured creditors<sup>5</sup> who have claims against the debtor must file their claims with the clerk of court within 90 days after the first date set for the meeting of creditors. Bankruptcy Rule 3002(c). In the typical no asset chapter 7 case, there is no need for creditors to file proofs of claim. If the trustee later recovers assets for distribution to unsecured creditors, creditors will be given notice of that fact and additional time to file proofs of claim. Although secured creditors are not required to file proofs of claim in chapter 7 cases in order to preserve their security interests or liens, there may be circumstances when it is desirable to do so. A creditor in a chapter 7 case who has a lien on the debtor's property should consult an attorney for advice.

The commencement of a bankruptcy case creates an "estate." The estate technically becomes the temporary legal owner of all of the debtor's property. The estate consists of all legal or equitable interests of the debtor in property as of the commencement of the case, including property owned or held by another person if the debtor has an interest in the property. Generally speaking, the debtor's creditors are paid from nonexempt property of the estate.

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. To accomplish this, the trustee attempts to liquidate the debtor's nonexempt property, i.e., property that the debtor owns free and clear of liens and the debtor's property which has market value above the amount of any security interest or lien and any exemption that the debtor holds in the property. The trustee also pursues causes of action (lawsuits) belonging to the debtor and pursues the trustee's own causes of action to recover money or property under the trustee's "avoiding powers." The trustee's avoiding powers include the power to set aside preferential transfers made to creditors within 90 days before the petition, the power to undo security interests and other prepetition transfers of property that were not properly perfected under nonbankruptcy law at the time of the petition, and the power to pursue nonbankruptcy claims such as fraudulent conveyance and bulk transfer remedies available under state law. In addition, if the debtor is a business, the bankruptcy court may authorize the trustee to operate the debtor's business for a limited period of time, if such operation will benefit the creditors of the estate and enhance the liquidation of the estate. 11 U.S.C. § 721.

The distribution of the property of the estate is governed by section 726 of the Bankruptcy Code, which sets forth the order of payment of all claims. Under section 726, there are six classes of claims, and each class must be paid in full before the next lower class is paid anything. The debtor is not particularly interested in the trustee's disposition of the estate assets, except with respect to the payment of those debts

Upon the filing of the chapter 7 petition, an impartial case trustee is appointed by the United States trustee (or by the court in Alabama and North Carolina) to administer the case and liquidate the debtor's nonexempt assets.

which for some reason are not dischargeable in the bankruptcy case. The debtor's major interests in a chapter 7 case are in retaining exempt property and in getting a discharge that covers as many debts as possible.

## DISCHARGE

A discharge releases the debtor from personal liability for discharged debts and prevents the creditors owed those debts from taking any action against the debtor or his property to collect the debts. The bankruptcy law regarding the scope of a chapter 7 discharge is com-

plex, and debtors should consult competent legal counsel in this regard prior to filing. As a general rule, however, excluding cases which are dismissed or converted, individual debtors receive a discharge in more than 99 percent of chapter 7 cases. In most cases, unless a complaint has been filed objecting to the discharge or the debtor has filed a written waiver, the discharge will be granted to a chapter 7 debtor relatively early in the case, that is, 60 to 90 days after the date first set for the meeting of creditors. Bankruptcy Rule 4004(c).

The grounds for denying an individual debtor a discharge in a chapter 7 case are very narrow and are construed against a creditor or trustee seeking to deny the debtor a chapter 7 discharge. Among the grounds for denying a discharge to a chapter 7 debtor are that the debtor failed to keep or produce adequate books or financial records; the debtor failed to explain satisfactorily any loss of assets; the debtor committed a bankruptcy crime such as perjury; the debtor failed to obey a lawful order of the bankruptcy court; or the debtor fraudulently transferred, concealed, or destroyed property that would have become property of the estate. 11 U.S.C. § 727; Bankruptcy Rule 4005.

In certain jurisdictions, secured creditors may retain some rights to seize pledged property, even after a discharge is granted. Depending on individual circumstances, a debtor wishing to keep possession of the pledged property, such as an automobile, may find it advantageous to “reaffirm” the debt. A reaffirmation is an agreement between the debtor and the creditor that the debtor will pay all or a portion of the money owed, even though the debtor has filed bankruptcy. In return, the

creditor promises that, as long as payments are made, the creditor will not repossess or take back the automobile or other property. Because there is a disagreement among the courts concerning whether a debtor whose debt is not in default may retain the property and pay under the original contract terms without reaffirming the debt, legal counsel should be consulted to ensure that the debtor’s rights are protected and that any reaffirmation is in the debtor’s best interest.

If the debtor elects to reaffirm the debt, the reaffirmation should be accomplished prior to the granting of a discharge. A written agreement to reaffirm a debt must be filed with the court and, if the debtor is not represented by an attorney, must be approved by the judge. 11 U.S.C. § 524(c). The Bankruptcy Code requires that reaffirmation agreements contain an explicit statement advising the debtor that the agreement is not required by bankruptcy or non-bankruptcy law. In addition, the debtor’s attorney is required to advise the debtor of the legal effect and consequences of such an agreement, including a default under such an agreement. The Code requires a reaffirmation hearing only if the debtor has not been represented by an attorney during the negotiating of the agreement. 11 U.S.C. § 524(d). The debtor may repay any debt voluntarily, however, whether or not a reaffirmation agreement exists. 11 U.S.C. § 524(f).

Most claims against an individual chapter 7 debtor are discharged. A creditor whose unsecured claim is discharged may no longer initiate or continue any legal or other action against the debtor to collect the obligation. A discharge under chapter 7, however, does not discharge an individual debtor from certain

specific types of debts listed in section 523 of the Bankruptcy Code. Among the types of debts which are not discharged in a chapter 7 case are alimony and child maintenance and support obligations, certain taxes, debts for certain educational benefit overpayments or loans made or guaranteed by a governmental unit, debts for willful and malicious injury by the debtor to another entity or to the property of another entity, debts for death or personal injury caused by the debtor's operation of a motor vehicle while the debtor was intoxicated from alcohol or other substances, and debts for criminal restitution orders under title 18, United States Code. 11 U.S.C. § 523(a). To the extent that these types of debts are not fully paid in the chapter 7 case, the debtor is still responsible for them after the bankruptcy case has concluded. Debts for money or property obtained by false pretenses, debts for fraud or defalcation while acting in a fiduciary capacity, debts for willful and malicious injury by the debtor to another entity or to the property of another entity, and debts arising from a property settlement agreement incurred during or in connection with a divorce or separation are discharged unless a creditor timely files and prevails in an action to have such debts declared excepted from the discharge. 11 U.S.C. § 523(c); Bankruptcy Rule 4007(c).

The court may revoke a chapter 7 discharge on the request of the trustee, a creditor, or the United States trustee if the discharge was obtained through fraud by the debtor or if the debtor acquired property that is property of the estate and knowingly and fraudulently failed to report the acquisition of such property or to surrender the property to the trustee. 11 U.S.C. § 727(d).

## NOTES

1. An involuntary chapter 7 case may be commenced under certain circumstances by the filing of a petition by creditors holding claims against the debtor. 11 U.S.C. § 303.
2. Each debtor in a joint case (both husband and wife) can claim exemptions under the federal bankruptcy laws. 11 U.S.C. § 522(m).
3. United States trustees and bankruptcy administrators are responsible for establishing a panel of private trustees to serve as trustees in chapter 7 cases and for supervising the administration of cases and trustees in cases under chapters 7, 11, 12, and 13 of the Bankruptcy Code. Bankruptcy administrators serve in the judicial districts in the states of Alabama and North Carolina.
4. A fee of \$645 is charged for converting, on request of the debtor, a case under chapter 7 to a case under chapter 11. There is no fee for converting from chapter 7 to chapter 13.
5. Unsecured debts generally may be defined as those for which the extension of credit was based purely upon an evaluation by the creditor of the debtor's ability to pay, as opposed to secured debts, for which the extension of credit was based upon the creditor's right to seize pledged property on default, in addition to the debtor's ability to pay.

# CHAPTER 13

## Individual Debt Adjustment

Chapter 13 of the United States Bankruptcy Code is frequently referred to as a “wage earner” chapter, although it is available to individuals with regular income from any source, not just wages.

### BACKGROUND

Chapter 13 is designed for individuals with regular income who desire to pay their debts but are currently unable to do so. The purpose of chapter 13 is to enable financially distressed individual debtors, under court supervision and protection, to propose and carry out a repayment plan under which creditors are paid over an extended period of time. Under this chapter, debtors are permitted to repay creditors, in full or in part, in installments over a three-year period, during which time creditors are prohibited from starting or continuing collection efforts. A plan providing for payments over more than three years must be “for cause” and be approved by the court. In no case may a plan provide for payments over a period longer than five years. 11 U.S.C. § 1322(d).

Any individual, even if self-employed or operating an unincorporated business, is eligible for chapter 13 relief as long as the individual’s unsecured debts are less than \$290,525 and secured debts are less than \$871,550. 11 U.S.C. § 109(e). A corporation or partnership may not be a chapter 13 debtor. *Id.*

An individual cannot file under chapter 13 or any other chapter if, during the preceding 180 days, a prior bankruptcy petition was dismissed due to the debtor’s willful failure to appear before the court or comply with orders

of the court or was voluntarily dismissed after creditors sought relief from the bankruptcy court to recover property upon which they hold liens. 11 U.S.C. §§ 109(g), 362(d) and (e).

## HOW CHAPTER 13 WORKS

A chapter 13 case begins with the filing of a petition with the bankruptcy court serving the area where the debtor has a domicile or residence. Unless the court orders otherwise, the debtor also shall file with the court (1) schedules of assets and liabilities, (2) a schedule of current income and expenditures, (3) a schedule of executory contracts and unexpired leases, and (4) a statement of financial affairs. Bankruptcy Rule 1007(b). A husband and wife may file a joint petition or individual petitions. 11 U.S.C. § 302(a). (Official Bankruptcy Forms can be purchased at a legal stationery store. They are not available from the court.)

Currently, the courts are required to charge a \$155 case filing fee and a \$39 miscellaneous administrative fee. The fees should be paid to the clerk of the court upon filing or may, with the court's permission, be paid in installments. 28 U.S.C. § 1930(a); Bankruptcy Rule 1006(b); Bankruptcy Court Miscellaneous Fee Schedule, Item 8. Rule 1006(b) limits to four the number of installments for the filing fee. The final installment shall be payable not later than 120 days after filing the petition. For cause shown, the court may extend the time of any installment, provided that the last installment is paid not later than 180 days after the filing of the petition. Bankruptcy Rule 1006(b). If a joint petition is filed, only one filing fee and one administrative fee are charged.

In order to complete the Official Bankruptcy Forms which make up the petition, statement of financial affairs, and schedules, the debtor will need to compile the following information:

1. A list of all creditors and the amounts and nature of their claims;
2. The source, amount, and frequency of the debtor's income;
3. A list of all of the debtor's property; and
4. A detailed list of the debtor's monthly living expenses, i.e., food, clothing, shelter, utilities, taxes, transportation, medicine, etc.

When a husband and wife file a joint petition or each spouse files an individual petition, the above detailed data must be gathered for both spouses. So that financial responsibilities can be accurately assessed when only one spouse files, the income and expenses of the non-filing spouse should be included in the debtor's schedules and statement of financial affairs.

Upon the filing of the petition, an impartial trustee is appointed to administer the case. 11 U.S.C. § 1302. If the number of cases so warrants, the United States trustee may appoint a standing trustee to serve in all chapter 13 cases in a district. 28 U.S.C. § 586(b). A primary role of the chapter 13 trustee is to serve as a disbursing agent, collecting payments from debtors and making distributions to creditors. 11 U.S.C. § 1302.

The filing of the petition under chapter 13 "automatically stays" most collection actions against the debtor or

the debtor's property. 11 U.S.C. § 362. As long as the "stay" is in effect, creditors generally cannot initiate or continue any lawsuits, wage garnishment, or even telephone calls demanding payments. Creditors receive notice of the filing of the petition from the clerk or the trustee. Further, chapter 13 contains a special automatic stay provision applicable to creditors. Specifically, after the commencement of a chapter 13 case, unless the bankruptcy court authorizes otherwise, a creditor may not seek to collect a "consumer debt" from any individual who is liable with the debtor. 11 U.S.C. § 1301. Consumer debts are those incurred for consumer, as opposed to business, needs.

By virtue of the automatic stay, an individual debtor faced with a threatened foreclosure of the mortgage on his or her principal residence can prevent an immediate foreclosure by filing a chapter 13 petition. Chapter 13 then affords the debtor a right to cure defaults on long-term home mortgage debts by bringing the payments current over a reasonable period of time. The debtor is permitted to cure a default with respect to a lien on the debtor's principal residence up until the completion of a foreclosure sale under state law. 11 U.S.C. § 1322(c).

The debtor must file a plan of repayment with the petition or within fifteen days thereafter, unless extended by the court for cause. Bankruptcy Rule 3015. The chapter 13 plan must provide for the full payment of all claims entitled to priority under section 507<sup>1</sup> (unless the holder of a particular claim agrees to different treatment of the claim); if the plan classifies claims, provide the same treatment for each claim within each class; and provide for the submission of

such portion of the debtor's future income to the supervision of the trustee as is necessary for the execution of the plan. 11 U.S.C. § 1322. Other plan provisions are permissive. *Id.* Plans, which must be approved by the court, provide for payments of fixed amounts to the trustee on a regular basis, typically biweekly or monthly. The trustee then distributes the funds to creditors according to the terms of the plan, which may offer creditors less than full payment on their claims. If the trustee or a creditor with an unsecured claim<sup>2</sup> objects to confirmation of the plan, the debtor is obligated to pay the amount of the claim or commit to the proposed plan all projected "disposable income" during the period in which the plan is in effect. 11 U.S.C. § 1325(b). Disposable income is defined as income not reasonably necessary for the maintenance or support of the debtor or dependents. If the debtor operates a business, disposable income is defined as excluding those amounts which are necessary for the payment of ordinary operating expenses. 11 U.S.C. § 1325(b)(2)(A) and (B).

A meeting of creditors is held in every case, during which the debtor is examined under oath. It is usually held 20 to 50 days after the petition is filed. If the United States trustee or bankruptcy administrator<sup>3</sup> designates a place for the meeting which is not regularly staffed by the United States trustee or bankruptcy administrator, the meeting may be held no more than 60 days after the order for relief. Bankruptcy Rule 2003(a). The debtor must attend the meeting, at which creditors may appear and ask questions regarding the debtor's financial affairs and the proposed terms of the plan.

11 U.S.C. § 343. If a husband and wife have filed a joint petition, they both must attend the creditors' meeting. The trustee will also attend the meeting and question the debtor on the same matters. In order to preserve their independent judgment, bankruptcy judges are prohibited from attending. 11 U.S.C. § 341(c). If there are problems with the plan, they are typically resolved during or shortly after the creditors' meeting. Generally, problems may be avoided if the petition and plan are complete and accurate and the trustee has been consulted prior to the meeting.

In a chapter 13 case, unsecured creditors who have claims against the debtor must file their claims with the court within 90 days after the first date set for the meeting of creditors. Bankruptcy Rule 3002(c). A governmental unit, however, may file a proof of claim until the expiration of 180 days from the date the case is filed. 11 U.S.C. § 502(b)(9).

After the meeting of creditors is concluded, the bankruptcy judge must determine at a confirmation hearing whether the plan is feasible and meets the standards for confirmation set forth in the Bankruptcy Code. 11 U.S.C. §§ 1324 and 1325. Creditors, who will receive 25 days' notice of the hearing, may object to confirmation. While a variety of objections may be made, the most frequent ones are that payments offered under the plan are less than creditors would receive if the debtor's assets were liquidated or that the debtor's plan does not commit all of the debtor's projected disposable income for the three-year period of the plan.

Within thirty days after the filing of the plan, even if the plan has not yet been approved by the court, the debtor

must start making payments to the trustee. 11 U.S.C. § 1326(a)(1). If the plan is confirmed by the bankruptcy judge, the chapter 13 trustee commences distribution of the funds received in accordance with the plan "as soon as practicable." 11 U.S.C. § 1326(a)(2). If the plan is not confirmed, the debtor has a right to file a modified plan. 11 U.S.C. § 1323. The debtor also has a right to convert the case to a liquidation case under chapter 7. 11 U.S.C. § 1307. If the plan or modified plan is not confirmed and the case is dismissed, the

If the number of cases so warrants, the United States trustee may appoint a standing trustee to serve in all chapter 13 cases in a district.

court may authorize the trustee to retain a specified amount for costs, but all other funds paid to the trustee are returned to the debtor. 11 U.S.C. § 1326(a)(2).

On occasion, changed circumstances will affect a debtor's ability to make plan payments, a creditor may object or threaten to object to a plan, or a debtor may inadvertently have failed

Once the court confirms the plan, it is the responsibility of the debtor to make the plan succeed. The debtor must make regular payments to the trustee, which will require adjustment to living on a fixed budget for a prolonged period.

to list all creditors. In such instances, the plan may be modified either before or after confirmation. 11 U.S.C. §§ 1323 & 1329. Modification after confirmation is not limited to an initiative by the debtor, but may be at the request of the trustee or an unsecured creditor. 11 U.S.C. § 1329(a).

#### MAKING THE PLAN WORK

The provisions of a confirmed plan are binding on the debtor and each creditor. 11 U.S.C. § 1327. Once the court confirms the plan, it is the responsibility of the debtor to make the plan suc-

ceed. The debtor must make regular payments to the trustee, which will require adjustment to living on a fixed budget for a prolonged period. Alternatively, the debtor's employer can withhold the amount of the payment from the debtor's paycheck and transmit it to the chapter 13 trustee. Furthermore, while confirmation of the plan entitles the debtor to retain property as long as payments are made, the debtor may not incur any significant new credit obligations without consulting the trustee, as such credit obligations may have an impact upon the execution of the plan. 11 U.S.C. §§ 1305(c), 1322(a)(1) & 1327.

A debtor may consent to the deduction of the plan payments from the debtor's paycheck. Experience has shown that this practice increases the likelihood that payments will be made on time and that the plan will be completed. In any event, failure to make the payments in accordance with the confirmed plan may result in dismissal of the case or its conversion to a liquidation case under chapter 7 of the Bankruptcy Code. 11 U.S.C. § 1307(c).

#### THE CHAPTER 13 DISCHARGE

The bankruptcy law regarding the scope of the chapter 13 discharge is complex and has recently undergone major changes. Therefore, debtors should consult competent legal counsel prior to filing regarding the scope of the chapter 13 discharge.

The chapter 13 debtor is entitled to a discharge upon successful completion of all payments under the chapter 13 plan. 11 U.S.C. § 1328(a). The discharge has the effect of releasing the debtor from all debts provided for by

the plan or disallowed (under section 502), with limited exceptions. Those creditors who were provided for in full or in part under the chapter 13 plan may no longer initiate or continue any legal or other action against the debtor to collect the discharged obligations.

In return for the willingness of the chapter 13 debtor to undergo the discipline of a repayment plan for three to five years, a broader discharge is available under chapter 13 than in a chapter 7 case. As a general rule, the debtor is discharged from all debts provided for by the plan or disallowed, except certain long term obligations (such as a home mortgage), debts for alimony or child support, debts for most government funded or guaranteed educational loans or benefit overpayments, debts arising from death or personal injury caused by driving while intoxicated or under the influence of drugs, and debts for restitution or a criminal fine included in a sentence on the debtor's conviction of a crime. 11 U.S.C. § 1328(a). To the extent that these types of debts are not fully paid pursuant to the chapter 13 plan, the debtor will still be responsible for these debts after the bankruptcy case has concluded.

### THE CHAPTER 13 HARDSHIP DISCHARGE

After confirmation of a plan, there are limited circumstances under which the debtor may request the court to grant a "hardship discharge" even though the debtor has failed to complete plan payments. 11 U.S.C. § 1328(b). Generally, such a discharge is available only to a debtor whose failure to complete plan payments is due to circumstances beyond the debtor's control and through no fault of the debtor, after

creditors have received at least as much as they would have received in a chapter 7 liquidation case and when modification of the plan is not possible. Injury or illness that precludes employment sufficient to fund even a modified plan may serve as the basis for a hardship discharge. The hardship discharge is more limited than the discharge described above and does not apply to any debts that are nondischargeable in a chapter 7 case. 11 U.S.C. § 523.

### NOTES

1. Section 507 sets forth nine categories of unsecured claims which Congress has, for public policy reasons, given priority of distribution over other unsecured claims.
2. Unsecured debts generally may be defined as those for which the extension of credit was based purely upon an evaluation by the creditor of the debtor's ability to pay. In contrast, secured debts are those for which the extension of credit was based upon not only the creditor's evaluation of the debtor's ability to pay, but upon the creditor's right to seize pledged property on default.
3. Bankruptcy Administrators, rather than U.S. trustees, serve in the judicial districts in the states of Alabama and North Carolina.

# *Bankruptcy Terminology*

## **ADVERSARY PROCEEDING**

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

## **ASSUME**

An agreement to continue performing duties under a contract or lease.

## **AUTOMATIC STAY**

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

## **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 ADMINISTRATOR**

An officer of the judiciary serving in the judicial districts of Alabama and North Carolina who, like the United States trustee, is responsible for supervising the administration of bankruptcy cases, estates, and trustees, monitoring plans and disclosure statements, monitoring creditors' committees, monitoring fee applications, and performing other statutory duties.

# LIST OF TERMS

Most debtors who file bankruptcy, and many of their creditors, know very little about the bankruptcy process. The Public Information Series of the Bankruptcy Judges Division is designed to provide debtors, creditors, judiciary employees, and the general public with a basic explanation of bankruptcy and how it works. The series features eight pamphlets that discuss chapter 7 (liquidation), chapter 13 (adjustment of debts of an individual with regular income), chapter 12 (adjustment of debts of a family farmer), chapter 11 (reorganization), chapter 9 (adjustment of debts of a municipality), SIPA (the Securities Investor Protection Act), the bankruptcy discharge, and bankruptcy terminology. This pamphlet on bankruptcy terminology explains, in layman's terms, many of the legal terms that are used in cases filed under 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 COURT

The bankruptcy judges in regular active service in each district; a unit of the district court.

## 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 JUDGE

A judicial officer of the United States district court who is the court official with decision-making power over federal bankruptcy cases.

## BANKRUPTCY MILL

A business not authorized to practice law that provides bankruptcy counseling and prepares bankruptcy petitions.

## BANKRUPTCY PETITION

A formal request for the protection of the federal bankruptcy laws. (There is an official form for bankruptcy petitions.)

## BANKRUPTCY TRUSTEE

A private individual or corporation appointed in all chapter 7, chapter 12, and chapter 13 cases to represent the interests of the bankruptcy estate and the debtor's creditors.

## BUSINESS BANKRUPTCY

A bankruptcy case in which the debtor is a business or an individual involved

in business and the debts are for business purposes.

## 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 7 TRUSTEE

A person appointed in a chapter 7 case to represent the interests of the bankruptcy estate and the unsecured creditors. (The trustee's responsibilities include reviewing the debtor's petition and schedules, liquidating the property of the estate, and making distributions to creditors. The trustee may also bring actions against creditors or the debtor to recover property of the bankruptcy estate.)

## CHAPTER 11

A reorganization bankruptcy, usually involving a corporation or partnership. (A chapter 11 debtor usually proposes a plan of reorganization to keep its business alive and pay creditors over time. People in business or individuals can also seek relief in chapter 11.)

## CHAPTER 12

The chapter of the Bankruptcy Code providing for adjustment of debts of a “family farmer,” as that term is defined in the Bankruptcy Code.

## 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.)

## CHAPTER 13 TRUSTEE

A person appointed to administer a chapter 13 case. (A chapter 13 trustee's responsibilities are similar to those of a chapter 7 trustee; however, a chapter 13 trustee has the additional responsibilities of overseeing the debtor's plan, receiving payments from debtors, and disbursing plan payments to creditors.)

## CLAIM

A creditor's assertion of a right to payment from a debtor or the debtor's property.

## COMPLAINT

The first or initiatory document in a lawsuit that notifies the court and the defendant of the grounds claimed by the plaintiff for an award of money or other relief against the defendant.

## CONFIRMATION

Approval of a plan of reorganization by a bankruptcy judge.

## CONSUMER BANKRUPTCY

A bankruptcy case filed to reduce or eliminate debts that are primarily consumer debts.

## CONSUMER DEBTS

Debts incurred for personal, as opposed to business, needs.

## CONTINGENT CLAIM

A claim that may be owed by the debtor under certain circumstances, for example, where the debtor is a cosigner on another person's loan and that person fails to pay.

## CREDITOR

A person to whom or business to which the debtor owes money or that claims to be owed money by the debtor.

## DEBTOR

A person who has filed a petition for relief under the bankruptcy laws.

## DEFENDANT

An individual (or business) against whom a lawsuit is filed.

## DISCHARGE

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

## DISCHARGEABLE DEBT

A debt for which the Bankruptcy Code allows the debtor's personal liability to be eliminated.

## DISCLOSURE STATEMENT

A written document prepared by the chapter 11 debtor or other plan proponent that is designed to provide "adequate information" to creditors to enable them to evaluate the chapter 11 plan of reorganization.

## 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 \$60,000 is subject to a \$30,000 mortgage, there is \$30,000 of equity.)

## EXECUTORY CONTRACT OR LEASE

Generally includes contracts or leases under which both parties to the agreement have duties remaining to be performed. (If a contract or lease is executory, a debtor may assume it or reject it.)

## EXEMPT

A description of any property that a debtor may prevent creditors from recovering.

## EXEMPTION

Property that the Bankruptcy Code or applicable state law permits a debtor to keep from creditors.

## EXEMPT PROPERTY

Property or value in property that a debtor is allowed to retain, free from the claims of creditors who do not have liens.

## FACE SHEET FILING

A bankruptcy case filed either without schedules or with incomplete schedules listing few creditors and debts. (Face sheet filings are often made for the purpose of delaying an eviction or foreclosure.)

## FAMILY FARMER

An individual, individual and spouse, corporation, or partnership engaged in a farming operation who meet certain debt limits and other statutory criteria for filing a petition under chapter 12.

## 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.

## FRESH START

The characterization of a debtor's status after bankruptcy, *i.e.*, free of most debts. (Giving debtors a fresh start is one purpose of the Bankruptcy Code.)

## INSIDER (of individual debtor)

Any relative of the debtor or of a general partner of the debtor; partnership in which the debtor is a general partner; general partner of the debtor; or corporation of which the debtor is a director, officer, or person in control.

## INSIDER (of corporate debtor)

A director, officer, or person in control of the debtor; a partnership in which the debtor is a general partner; a general partner of the debtor; or a relative of a general partner, director, officer, or person in control of the debtor.

## JOINT ADMINISTRATION

A court-approved mechanism under which two or more cases can be administered together. (Assuming no conflicts of interest, these separate firms or individuals can pool their resources, hire the same professionals, etc.)

## JOINT PETITION

One bankruptcy petition filed by a husband and wife together.

## LIEN

A charge upon specific property designed to secure payment of a debt or performance of an obligation.

## LIQUIDATION

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

### LIQUIDATED CLAIM

A creditor's claim for a fixed amount of money.

### MOTION TO LIFT THE AUTOMATIC STAY

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

### NO-ASSET CASE

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

### NONDISCHARGEABLE DEBT

A debt that cannot be eliminated in bankruptcy.

### OBJECTION TO DISCHARGE

A trustee's or creditor's objection to the debtor's being released from personal liability for certain dischargeable debts.

### OBJECTION TO EXEMPTIONS

A trustee's or creditor's objection to a debtor's attempt to claim certain property as exempt, *i.e.*, not liable for any prepetition debt of the debtor.

### PARTY IN INTEREST

A party who is actually and substantially interested in the subject matter, as distinguished from one who has only a nominal or technical interest in it.

### PLAN

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

### PLAINTIFF

A person or business that files a formal complaint with the court.

### POSTPETITION TRANSFER

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

### PREBANKRUPTCY PLANNING

The arrangement (or rearrangement) of a debtor's property to allow the debtor to take maximum advantage of exemptions. (Prebankruptcy planning typically includes converting nonexempt assets into exempt assets.)

### 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.

### PRIORITY

The Bankruptcy Code's statutory ranking of unsecured claims that determines the order in which unsecured claims will be paid if there is not enough money to pay all unsecured claims in full.

### PRIORITY CLAIM

An unsecured claim that is entitled to be paid ahead of other unsecured claims that are not entitled to priority status. Priority refers to the order in which these unsecured claims are to be paid.

### PROOF OF CLAIM

A written statement describing the reason a debtor owes a 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.

## REAFFIRMATION AGREEMENT

An agreement by a chapter 7 debtor to continue paying a dischargeable debt after the bankruptcy, usually for the purpose of keeping collateral or mortgaged property that would otherwise be subject to repossession.

## SECURED CREDITOR

An individual or business holding a claim against the debtor that is secured by a lien on property of the estate or that is subject to a right of setoff.

## 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.

## SCHEDULES

Lists submitted by the debtor along with the petition (or shortly thereafter) 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.

## SUBSTANTIAL ABUSE

The characterization of a bankruptcy case filed by an individual whose debts are primarily consumer debts where the court finds that the granting of relief would be an abuse of chapter 7 because, for example, the debtor can pay its debts.

## SUBSTANTIVE CONSOLIDATION

Putting the assets and liabilities of two or more related debtors into a single pool to pay creditors. (Courts are reluctant to allow substantive consolidation since the action must not only justify the benefit that one set of creditors receives, but also the harm that other creditors suffer as a result.)

## 341 MEETING

A meeting of creditors at which the debtor is questioned under oath by creditors, a trustee, examiner, or the United States trustee about his/her financial affairs.

## 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 United States trustee or Bankruptcy Administrator.

## TYPING SERVICE

A business not authorized to practice law that prepares bankruptcy petitions.

## UNITED STATES TRUSTEE

An officer of the Justice Department responsible for supervising the administration of bankruptcy cases, estates, and trustees, monitoring plans and disclosure statements, monitoring creditors' committees, monitoring fee applications, and performing other statutory duties.

## UNDERSECURED CLAIM

A debt secured by property that is worth less than the amount of the debt.

## UNLAWFUL DETAINER ACTION

A lawsuit brought by a landlord against a tenant to evict the tenant from rental property—usually for non-payment of rent.

## UNLIQUIDATED CLAIM

A claim for which a specific value has not been determined.

## UNSCHEDULED DEBT

A debt that should have been listed by a 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.

## VOLUNTARY TRANSFER

A transfer of a debtor's property with the debtor's consent.

## SOURCES

Doran, *Personal Bankruptcy and Debt Adjustment*, 135–139 (1991)

Griffin, *Personal Bankruptcy: What You Should Know*, 145–149 (1994)



Administrative Office of the United States Courts

Thurgood Marshall Federal Judiciary Building

Washington, D.C. 20544

PHONE: (202) 502-1900