AMERICAN BANKRUPTCY INSTITUTE

2021 Consumer Practice Extravaganza

Intro to Chapter 7

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Overview of Bankruptcy Law

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I. INTRODUCTION

A. Purpose of Bankruptcy

1. Fresh start for debtors; and

2. Breathing room from creditors.

B. Warning: The Pitfalls of Bankruptcy

1. Complex code-based law with a heavy interrelation with the various Federal and Local Rules.

2. Recent bankruptcies can affect the automatic stay and the debtor's right to a discharge.

3. In Chapter 11 in particular, the first week of bankruptcy is document- and filing-intensive and comprises multiple important deadlines

4. Debtor comprehension of the effect of a Chapter 7—what happens to a debtor's property and what a Chapter 7 can and cannot accomplish—is often imperfect.

II. GOVERNING LAW

C. Title 11 of the United States Code[1]

1. Chapters 1, 3, and 5 apply to all cases; and

2. Chapters 7, 9, 11, 12, 13, and 15 apply to specific types of cases.

3. Title 11 available on multiple internet sites

a) US House of Representatives:
http://uscode.house.gov/download/title_11.shtml

b) Cornell Law School
http://www.law.cornell.edu/uscode/html/uscode11/usc_sup_01_11.html

D. Property rights are determined by state law. *Butner v. United States* (1970) 440 U.S. 48.

1. California Law available on multiple websites
http://www.leginfo.ca.gov/calaw.html

[1] There is technically no such thing as the "Bankruptcy Code," but practitioners and laymen alike often refer to Title 11 as the Bankruptcy Code. We generally do not.

E. Federal Rules of Bankruptcy Procedure ("FRBP") is an Appendix to Title 11 of the United States Code.

1. FRBP available on multiple websites

a) United States Court

http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK-Rules.pdf

b) Cornell Law School

http://www.law.cornell.edu/uscode/html/uscode11a/usc_sup_05_11_10_sq1.html

F. Federal Rules of Civil Procedure often apply in bankruptcy cases.

http://www.law.cornell.edu/uscode/html/uscode28a/usc_sup_05_28_10_sq4.html

G. Federal Rules of Evidence apply in bankruptcy cases

http://www.law.cornell.edu/uscode/html/uscode28a/usc_sup_10_sq5.html

H. Local Bankruptcy Rules are available on the Court's website www.cacb.uscourts.gov

I. Local-Local Rules (aka Individual Practices). *See*, "Information" tab on court's website for particular rules and requirements which can vary by Judge. www.cacb.uscourts.gov

J. Self-Calendaring: Most of the judges post available hearing dates for self-calendaring.

K. Forms. Many motions require use of mandatory forms available on the court's website.

L. The United States Trustee Program (the "US Trustee") is a component of the Department of Justice responsible for overseeing the administration of bankruptcy cases and private trustees under 28 U.S.C. §586 and 11 U.S.C. §101, *et seq*. The US Trustee is charged with a duty to ensure that Chapter 7 Debtors pass the means test, that attorneys and paralegals not charge unreasonable fees, etc. Bankruptcy practitioners should be familiar with the US Trustee's rules and regulations which can be viewed at http://www.justice.gov/ust

III. OTHER HELPFUL INFORMATION RE: BANKRUPTCY PRACTICE

A. United States Bankruptcy Court for the Central District of California: www.cacb.uscourts.gov

B. Tentative Rulings are generally posted to the Court's website the evening before hearings.

1. Computer Web Access: http://ecf-ciao.cacb.uscourts.gov/CiaoPosted

2. Mobile Device Access: http://ecf-ciao.cacb.uscourts.gov/tr

C. High-speed Wi-Fi in Courtrooms provided by the Bankruptcy Court to all registered users of Electronic Case Files ("ECF"). To obtain the access code, ECF users can call 213-894-2365.

D. Public Access to Court Electronic Records ("PACER") provides access to dockets and pleadings for federal courts across the country. Users must set up an account to access. http://www.pacer.gov/psco/cgi-bin/links.pl

IV. COMMENCING BANKRUPTCY CASES

A. Voluntary vs. Involuntary Petition

1. Voluntary cases are filed by a petition signed by debtor under penalty of perjury. 11 U.S.C. § 301.

a) Eligibility: Generally, any "person" who "resides or has a domicile, a place of business, or property in the United States" can file. 11 U.S.C. § 109(a). "Persons" include individuals, corporations, partnerships, LLC's, etc. Requires authorizations such as a corporate resolution, etc.

b) Consumer Debtors: Individuals whose debts are primarily consumer must obtain credit counseling prior to filing.

2. Involuntary cases are filed by creditors against an alleged debtor.

a) Creditor remedy to force debtor into a Chapter 7 or Chapter 11.

b) Commenced by filing of petition for order for relief. 11 U.S.C. § 303.

c) Grounds: (1) alleged debtor generally not paying debts as they become due; or (2) within 120 days a custodian or receiver was appointed or took possession of substantially all of the alleged debtor's property.

d) Number of Petitioning Creditors. If debtor has fewer than 12 creditors, then any single creditor holding an unsecured or undersecured claim of at least $10,000 that is not contingent as to liability or subject to *bona fide* dispute may sign the petition. If the debtor has more than 12 creditors,

then three creditors must sign the petition.

- ❖ Practitioner's Note: The free online resources, including those cited in this outline, are ***often out of date*** with respect to current applicable dollar amounts. These include the amounts for California exemptions (*see* below) and the 11 U.S.C. § 303(b)(2) undersecured claim amount. Always be careful to double check your dollar figures for recent changes.

e) If debtor defeats petition, then petitioning creditors subject to paying attorneys' fees of alleged debtor.

B. Pre-Bankruptcy Thoughts

1. Query whether bankruptcy is appropriate or whether your client should be considering out-of-court workouts (*see* below).
2. Be aware of filing options, including emergency petitions.
3. Be aware of the documents required to be filed for the different Chapters, including which must be filed on the petition date and which, in the case of emergency filing, may be filed within specified periods after the petition date.
4. For a Chapter 7, ensure that your client is fully aware of the consequences of her filing and her chapter election.
5. For a Chapter 11, ensure you have your first-day motions lined up as well as your required petition documents before you pull the trigger. Ensure that your client is aware of the sometimes onerous responsibilities of a debtor-in-possession and the fiduciary duties she is taking on.
6. Be aware of the counseling requirements and ensure your client is prepared to meet them:
    a. Pre-Petition Counseling. Client must have completed credit counseling within the 180-day period prior to bankruptcy from an approved credit counseling agency, or her case will be dismissed (certain exceptions exist, but they are almost never applicable). See 11 U.S.C. § 109 (h)(1).

b. Post-Petition Pre-Discharge Counseling. Client must complete a financial management after the filing of her petition, or her discharge will be withheld.

C. Chapter 7 - Liquidation

1. Summary: Trustee appointed to liquidate assets to pay creditors. Chapter 7 cases are typically filed by individuals seeking to discharge pre-bankruptcy debts. Liens survive bankruptcy.

2. Qualifications - Means Test. Individuals whose debts are primarily consumer must make less than the median income for their state of residence. California's current median income for a one-person household is $53,644 and for a four-person household is $89,444. Based on last six full months multiplied by two. Because the figures change, practitioners should always check the current amounts. A chart is available on the website for the United States Trustee Program at the following website: http://www.justice.gov/ust/eo/bapcpa/20171101/bci_data/median_income_table.htm

D. Chapter 11 - Reorganization

1. Summary: Debtor remains in possession (i.e. no trustee automatically appointed). Chapter 11 cases are typically filed by individuals or businesses with complex financial issues and substantial amounts of creditors. Chapter 11 cases are very expensive.

2. Qualifications. There are generally no debt or income limits for Chapter 11 debtors.

E. Chapter 13 – Individual Debt Adjustment

1. Summary. Individuals with regular income seek to confirm a plan to repay creditors over a maximum of five years. Typically, Chapter 13 cases are filed by individuals seeking to reinstate mortgage defaults over time.

2. Limited to individuals with regular income. Current debt limitations are $394,725 of unsecured debt; and $1,184,200 in secured debt. Current limitations posted at: http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter13.aspx

These debt limitations are adjusted every three years. Next adjustment is April 1, 2019. Debt limits are jurisdictional.

V. THE BANKRUPTCY ESTATE

A. Property of Estate: All of the debtor's legal and equitable interests in property "as of the commencement of the case." 11 U.S.C. § 541(a). Broadly defined and includes contract rights, causes of action, etc.

1. Post-petition wages: Included in Chapters 11 and 13. Not in Chapter 7;

2. Community property is property of estate. Even if an asset held only in name of non-filing spouse.

3. Joint tenancy / Separate Property. Previously, the rule was if property was held in joint tenancy, each spouse was deemed to have a one-half separate property interest. In 2014, the California Supreme Court issued an opinion in *Valli v. Valli (In re Marriage of Valli*), 58 Cal. 4th 1396, 1400 (2014), stating that for divorce and family law purposes property acquired after marriage was presumed to be community property, absent a further writing. The Supreme Court had to decide if the "record title" presumption in the Evidence Code trumped the community property presumption in the Family Law Code. In *In re Brace* (*Brace v. Speier*), 566 B.R. 13 (9th Cir. BAP 2017), citing the California Supreme Court opinion in *Valli,* the Court held that for purposes of characterization of property in a bankruptcy case, the *Valli* decision would apply and the presumption of community property would trump recorded title. In sum, the Court held as a general rule, California's community property presumption applies in disputes in bankruptcy involving the characterization of marital property. *Brace* is currently on appeal.

4. Property Inherited Post-Petition. Property acquired by a Chapter 7 debtor within 180 days after petition date through a bequest, devise, or inheritance.

❖ Practitioner's Note: 180 day limit may not apply to Chapter 13 debtors.

B. Exclusions from Property of Estate. 11 U.S.C. § 541(c)(2) excludes property held in trust that contains restriction on transfer enforceable under applicable non-bankruptcy law. Thus, ERISA-qualified pension plans or spendthrift trusts can be excluded from estate.

VI. EXEMPTIONS

A. Exempt property is not subject to administration by a trustee. 11 U.S.C. § 522(c). Technically, exempt property is removed from the estate (compare to excluded property, which never comes into the estate).

1. Exemptions Limited to Individuals. Only individuals are entitled to exempt property (i.e. not businesses).

2. Opt-out. Title 11 provides that states can opt out of federal exemptions and provide for state exemptions to be applicable in bankruptcy cases. 11 U.S.C. § 522. California has opted out. Thus, California exemptions under either CCP § 703.140 (the wildcard section) or CCP §§ 704 et seq. (the homestead sections) apply. Title 11 also provides that the first $1 million of a retirement account is exempt pursuant to 11 U.S.C. § 522.

3. List of Most Common Exemptions and Amounts. The Judicial Council maintains a list of the most common exemptions and their current amounts.

4. Specific exemptions.

a) Homestead. As of January 1, 2010, amounts increased. $75,000 for single individuals; $100,000 for family units; and $175,000 for seniors and disabled individuals. *See, e.g.* CCP § 704.730. Applies to individual's interest in property even if only a one-half joint tenancy interest. Different treatment for recorded declarations of homestead.

❖ Practitioner's Note: ***Six month exemption for proceeds of sale apply only if a declaration of homestead had been recorded.*** CCP

§ 704.760.

b) Retirement Accounts. $1 million if tax qualified plan. 11 U.S.C. § 522(n). Must be used principally for retirement purposes. *In re Dudley*, 249 F.3d 1170 (9th Cir. 2001).

c) Life insurance policies. Cash value exemption limited to $9,700 per debtor. CCP § 704.100.

d) Spendthrift trusts. 75% of interest in qualified spendthrift trust is excluded from estate under 11 U.S.C. § 541(c)(2). Remaining 25% potentially exempt under California, Probate Code §§ 15300 *et seq*. and CCP Section 709.010. However, in *Carmack v. Reynolds,* 2 Cal. 5th 844, 215 Cal. Rptr. 3d 749, 391 P.3d 625 (2017), the California Supreme Court stated that all proceeds of a spendthrift trust are inaccessible if the trust specifically states the funds are for support and education and the funds in fact are need for support and education. Note, once payable there is no spendthrift and no protection. At your request a detailed analysis of the treatment of spendthrift trusts can be obtained from Marshack Hays, LLP.

5. Objections to Exemptions. Any party in interest, including creditors or the Trustee, can file an objection to a debtor's claimed exemptions. Usually, objection must be filed within 30 days after the conclusion of the §341(a) meeting of creditors or within 30 days after the debtor files an amended Schedule C (the exemptions schedule). Further time may be granted by the Court. Other deadlines apply in certain unusual circumstances. *See* FRBP 4003.

VII. THE AUTOMATIC STAY

A. Injunction. The filing of the bankruptcy creates an automatic stay. 11 U.S.C. § 362(a). The stay generally prohibits creditors from enforcing pre-bankruptcy claims or from exercising control over estate property. The purpose of the stay is to give the debtor breathing room and to preserve the estate for orderly and pro rata distributions.

1. Arises automatically.

2. Creditors have affirmative duty to cease enforcing claims.

3. Violations subject offending party to sanctions. 11 U.S.C. § 362(k) which provides that the court "shall" award "actual damages" including costs and attorneys' fees to an "individual" injured by a willful violation of the stay. "Individual" does not include corporations, partnerships or bankruptcy trustees. Recoverable attorneys' fees do not include the fees for proving up violation of stay.

4. Actions that violate the stay are void and not voidable.

5. Exceptions to automatic stay found in 11 U.S.C. § 362(b). Does not enjoin criminal prosecutions, certain family law issues including custody and visitation, and police powers.

6. Duration of Stay as to Estate Property. With regard to estate property, the stay "continues until such property is no longer property of the estate." 11 U.S.C. § 362(c)(1). Property ceases to be property of the estate after it is sold, abandoned or exempted.

7. Duration of Stay as to Debtor or Debtor's Property. Stay terminates upon case being closed or dismissed. Also, with regard to individual debtors, the stay terminates after the debtor is granted or denied a discharge. 11 U.S.C. § 362(c)(2).

B. Relief from Stay. A creditor can file a motion for seeking a court order granting relief from stay for such things including foreclosure, adequate protection or continuation of a non-bankruptcy action. 11 U.S.C. § 362(d). Section 362(d) provides three (3) grounds for obtaining relief from the automatic stay. The first ground for obtaining relief from the automatic stay is set forth in § 362(d)(1), which states that relief from the stay may be granted "for cause, including the lack of adequate protection of an interest in property..." Secured creditors, and certain other parties that have an interest in property of the estate, are entitled to adequate protection to protect against diminution in the value of their collateral. Note that § 362(d)(1) refers to "***cause***, including the lack of adequate

protection...". Some other situations found to constitute cause are: failure to maintain and preserve collateral, waste or mismanagement, failure to pay taxes, and undue delay by the debtor in proposing a reorganization plan. The next basis for granting relief from the automatic stay is found in § 362(d)(2). Section 362(d)(2) provides that a secured creditor may obtain relief from the automatic stay with respect to an act against property of the bankruptcy estate if (A) the debtor does not have an equity in such property, and (B) such property is not necessary to an effective reorganization. The third basis for granting relief from the automatic stay is found in § 362(d)(3). Section 362(d)(3) provides that a secured creditor is entitled to relief from the stay to foreclose on its collateral unless the debtor has filed a reorganization plan that has a reasonable prospect for confirmation or begins paying monthly interest to the secured creditor at a market rate of interest by no later than 90 days after the bankruptcy filing (although the court has the power to extend this period). It is important to emphasize, however, that 362(d)(3) applies only to those single-asset real estate cases involving less than $4 million in debt, a relatively small subset of chapter 11 cases.

C. Automatic Termination of the Stay By Operation of Law. When a debtor files a bankruptcy case within one year of dismissal of a previously filed bankruptcy case, the automatic stay terminates "with respect to the debtor" upon 30 days after the filing of the second case. 11 U.S.C. § 362(c)(2)(A). The majority of courts who have addressed the issue conclude that the plain language of §362(c)(3) provides that the stay terminates with respect to the debtor **but not with respect to the estate**. See *In re Rinard* 451 B.R. 12, 20 (Bankr. C.D. Cal. 2011). A minority of courts have concluded that if a previous bankruptcy by the same debtor was pending and dismissed in the previous year, on the 30th day following the second filing by that debtor the stay terminates in its entirety: **that is, with respect to the debtor and with respect to the estate**. See *In re Reswick*, 446 B.R. 362 (9th Cir. B.A.P. 2011). In such circumstances, a motion to impose the stay can be brought based on the second case having been filed in good faith, or if the property is of consequential value or benefit to the estate. 11 U.S.C. § 362(c)(3).

VIII. DISCHARGE

A. General Discharge. 11 U.S.C. § 727 provides that all qualified individual debtors are entitled to discharge of debts unless timely complaint filed and judgment entered denying discharge. Purpose of discharge is to provide a fresh start to honest but unfortunate debtors.

1. Grounds include: (a) false oaths; (b) transfer of assets within one year with actual intent to hinder, delay or defraud creditors; and (c) failure to explain dissipation of assets.
2. Burden of proof on creditor.
3. No pre-petition waivers of discharge.
4. Only one discharge every 8 years measured from petition date.
5. Liens survive bankruptcy even if debtor discharges debt.
6. Discharge generally does not extend to non-debtors. Compare to community property discharge under 11 U.S.C. § 524(a)(3).
7. Discharge is actually a permanent injunction against enforcement.
8. Enforceable by contempt.

B. Exceptions to Discharge. 11 U.S.C. § 523 provides that certain debts are not discharged.

1. Fraud. 11 U.S.C. § 523(a)(2).
2. Breach of fiduciary duty. 11 U.S.C. § 523(a)(4).
3. Willful and malicious injury. 11 U.S.C. § 523(a)(6).
4. Domestic Support. Automatically non-dischargeable in all chapters per 11 U.S.C. § 523(a)(5).
5. Non-Support Awards to former spouses not dischargeable in any chapter except in Chapter 13 after entry of a full compliance discharge per 11 U.S.C. § 523(a)(15).

IX. LITIGATION

A. Adversary Proceedings v. Contested Matters: The Groundwork. There are two basic types of litigation in Bankruptcy Court: Adversary Proceedings and contested matters.

1. Adversary Proceedings are separate lawsuits filed in the bankruptcy court and related to but not consolidated with the underlying bankruptcy proceeding. (1:11-ap-12345-SC v. 1:11-bk-54321-SC). What constitutes an adversary proceeding (as opposed to what can be resolved by contested matter) is governed by FRBP 7001.

2. Contested Matters are what we would commonly call motion practice within the underlying bankruptcy itself. Procedural issues for contested matters are addressed at FRBP 9014.

B. Adversary Proceedings.

1. Discharge. Any party in interest may bring an adversary proceeding for determination of dischargeability of a particular debt, also known as exceptions to discharge (11 U.S.C. § 523, *see* discussion above) or for denial or revocation of the debtor's discharge (11 U.S.C. § 727, *see* discussion above).

   ❖ Practitioner's Note: Knowing the causes of action and elements for exception to discharge, denial of discharge, and revocation of discharge can help you advise a client pre-petition what her risks in bankruptcy may be. It will also assist you in formulating a set of guidelines for your client: having clear do's and don'ts both before and after her filing will keep your client on track and may help keep you out of a malpractice suit.

2. Avoidance Actions and Trustee's Strong-Arm Powers

   a. Strong-arm powers. 11 U.S.C. § 544(a) gives trustee powers of hypothetical judicial lien creditor or hypothetical bona fide purchaser of real property. Can be used to defeat unperfected liens or interests.

   b. Preferences. 11 U.S.C. § 547(b) provides that a trustee or debtor-in-possession can avoid a transfer of an interest of a debtor in property, on account of an antecedent debt, that allows the creditor to recover more than under a chapter 7. Non-insiders subject to a 90 day reach-back.

Insiders subject to a one year reach-back.

i. Common Defenses. (a) subsequent new value; (b) contemporaneous exchange of new value; and (c) ordinary course of business. *See*, 11 U.S.C. § 547(c).

c. Fraudulent transfers. 11 U.S.C. § 548 provides that a trustee or debtor-in-possession can avoid actual or constructively fraudulent transfers. Two year reach back. However, under 11 U.S.C. § 544, California's four year statute of limitations applicable.

d. Post-petition transfers. 11 U.S.C. § 549 allows for avoidance of unauthorized post-petition transfers initiated by the debtor. Section 362 voids unauthorized post-petition transfers initiated by creditors.

e. Recovery of avoided transfers. 11 U.S.C. § 550 allows for recovery of an avoided transfer. Initial transferee strictly liable. Subsequent transferees liable unless they took in good faith, for value and without knowledge of avoidability of transfer.

3. Contested Matters. List of common types (non-exhaustive):

a. Motions for relief from the automatic stay. FRBP 4001(a).

b. Motions for use of cash collateral. FRBP 4001(b).

c. Motions to obtain credit. FRBP 4001(c).

d. Avoidance of liens. 11 U.S.C. §522(f).

e. Assumptions, rejection, or assignment of executor contracts. 11 U.S.C. § 365.

f. Appointment of a trustee or examiner. FRBP 2007.1.

g. Dismissal or conversion of a case. FRBP 1017(f)(1).

h. Use, sale, or lease of real property. FRBP 6004.

i. Objection to claim. FRBP 3007.

X. ALTERNATIVES TO BANKRUPTCY

A. Out of court workout—Informal

1. Debtor – creditor negotiator

2. Problem: Need full consensus

B. Out of court workout—Formal

1. Credit Managers Associate calls or meeting of creditors

C. Assignment for Benefit of Creditors. CCP § 1800 *et seq*.

D. Deeds in Lieu.

Chapter 7 101: An Introduction to the Bankruptcy Code, Rules and Practice Creditor's Rights

I. Introduction to Chapter 7

Chapter 7 is the liquidation chapter available to individuals, partnerships, corporations and certain other business entities. A Chapter 7 case begins with the debtor filing a petition with the bankruptcy court serving the area where the individual lives or where the business debtor is organized or has its principal place of business or principal assets. In addition to the petition, the debtor must also file with the court: (1) schedules of assets and liabilities; (2) a schedule of current income and expenditures; (3) a statement of financial affairs; and (4) a schedule of executory contracts and unexpired leases. Individual debtors with primarily consumer debts have additional document filing requirements.

The filing of a petition under Chapter 7 "automatically stays" (stops) most collection actions against the debtor or the debtor's property. However, filing the petition does not stay certain types of actions listed under 11 U.S.C. §362(b), and the stay may be effective only for a short time in some situations. The stay arises automatically by law and requires no judicial action. As long as the stay is in effect, creditors may not initiate or continue lawsuits, wage garnishments, or even telephone calls demanding payments.

When a Chapter 7 petition is filed, the U.S. Trustee appoints a case trustee to administer the case and liquidate the debtor's nonexempt assets. The Trustee will initially review each case to determine whether it is an "asset case" or a "no asset case." Most Chapter 7 cases involving individual debtors are no asset cases. However, if the case appears to be an "asset case" at the outset, unsecured creditors must file their claims with the court within 90 days after the first date set for the meeting of creditors. In the typical no asset case, there is no need for creditors to file

proofs of claim because there will be no distribution. If the trustee later recovers assets for distribution to unsecured creditors, the court will provide notice to creditors and will allow additional time to file proofs of claim. Although a secured creditor does not need to file a proof of claim in a Chapter 7 case to preserve its security interest or lien, there may be other reasons to file a claim.

Between 21 and 60 days after the Chapter 7 petition is filed, the case trustee will hold a meeting of creditors. During this meeting, the trustee puts the debtor under oath, and the trustee and creditors may ask questions. The debtor is required to attend the meeting and answer questions regarding the debtor's financial affairs and property.

Under Chapter 7, the debtor turns over all assets owned at the time of bankruptcy to a trustee for liquidation. However, individuals are permitted to retain certain exempt assets. The trustee, following collection and liquidation of all available assets, distributes assets or their proceeds to secured creditors according to their lien rights and then distribute unencumbered assets to priority and unsecured creditors on a pro rata basis according to their classification.

The distribution is determined by whether the claim is secured, unsecured with priority, unsecured without priority or equity interest. In most cases, only secured creditors and priority creditors receive any distribution. Usually, there is not enough to pay priority creditors in full and unsecured creditors receive nothing.

A discharge releases individual debtors from personal liability for most debts and prevents the creditors owed those debts from taking any collection actions against the debtor. In most individual Chapter 7 cases, unless a party files a complaint objecting to the discharge or a motion to extend the time to object, the court will issue a discharge order relatively early – approximately 60 to 90 days after the date first set for the meeting of creditors.

Presented by: Heather Giannino of Heavner, Beyers & Mihlar, LLC

The grounds for denying an individual debtor a discharge in a Chapter 7 case are narrow and are construed against the moving party. Among other reasons, the court may deny the debtor a discharge if it finds that the debtor: failed to keep or produce adequate books or financial records; failed to explain satisfactorily any loss of assets; committed a bankruptcy crime such as perjury; failed to obey a lawful order of the bankruptcy court; fraudulently transferred, concealed, or destroyed property that would have become property of the estate; or failed to complete an approved instructional course concerning financial management.

Secured creditors may retain some rights to seize property securing an underlying debt even after a discharge is granted. Depending on individual circumstances, if a debtor wishes to keep certain secured property (such as an automobile), he or she may decide to "reaffirm" the 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. In return, the creditor promises that it will not repossess or take back the automobile or other property so long as the debtor continues to pay the debt. If the debtor decides to reaffirm a debt, he or she must do so before the discharge is entered. The debtor must sign a written reaffirmation agreement and file it with the court. The Bankruptcy Code requires that reaffirmation agreements contain an extensive set of disclosures. The Bankruptcy Code requires a reaffirmation hearing if the debtor has not been represented by an attorney during the negotiating of the agreement, or if the court disapproves the reaffirmation agreement.11 U.S.C. §524(d) and (m). The debtor may repay any debt voluntarily, however, whether or not a reaffirmation agreement exists. 11 U.S.C. §524(f).

An individual receives a discharge for most of his or her debts in a Chapter 7 bankruptcy case. A creditor may no longer initiate or continue any legal or other action against the debtor to

collect a discharged debt. But not all of an individual's debts are discharged in Chapter 7. Debts not discharged include debts for alimony and child support, 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 certain criminal restitution orders. The debtor will continue to be liable for these types of debts to the extent that they are not paid in the Chapter 7 case. Debts for money or property obtained by false pretenses, debts for fraud or defalcation while acting in a fiduciary capacity, and debts for willful and malicious injury by the debtor to another entity or to the property of another entity will be discharged unless a creditor timely files and prevails in an action to have such debts declared nondischargeable.

II. Automatic Stay – Section 362

When any type of bankruptcy case is filed (voluntary or involuntary), an automatic stay (injunction) is immediately imposed on all creditors. This stay precludes the commencement or continuation of any action against the debtor or its property and prohibits any action to try to collect a pre-petition debt or to enforce a judgment or lien. Any action taken without court approval after the bankruptcy is filed is a violation of the automatic stay, whether or not the creditor knows of the bankruptcy filing. Moreover, any action taken in violation of the stay is void. Additionally, if creditors *knowingly* violate the stay, they may be subject to contempt proceedings before the bankruptcy court and the imposition of substantial fines, including payment of attorneys' fees.

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However, filing the bankruptcy petition does not stay certain matters listed under 11 U.S.C. §362(b), and the stay may be effective only for a short period of time in certain circumstances. While creditors contact with the debtor should end with the filing of the petition, note that the debtor's mere threat to file, or falsely stating that a bankruptcy has been filed, does not invoke the stay. If the debtor asserts that a petition has been filed, the creditor may ask for the case number and the name of the debtor's attorney, without violating the stay.

The automatic stay is applied broadly and prohibits initiation or continuation of the following actions:

- Any act to collect a debt, including telephone calls, letters or litigation
- Enforcement of a pre-petition judgment
    - Wage garnishments or frozen bank accounts
    - Evictions
    - Repossession of vehicles
- Creation, perfection or enforcement of any lien
    - Secured creditor's actions to enforce lien rights, including foreclosure on property or repossession of collateral, regardless of whether the property is property of the debtor or property of the bankruptcy estate.
- Filing a new lawsuit or proceeding with a pending action
- Unilateral termination of a contract

The Bankruptcy Code, under §362(b), itemizes a number of exceptions from the protection of the automatic stay. The exceptions include criminal proceedings, injunctive relief, governmental proceedings to enforce police and regulatory powers, certain consensual security

interests, statutory liens, reclamation by written demand, alimony and support exceptions. Exceptions to the automatic stay are typically based on a policy objective.

BAPCPA added additional provisions providing for exceptions from the automatic stay for commencement or continuation of civil actions for the establishment of paternity, establishment or modification of an order for domestic support obligations, concerning child custody or visitation, for the dissolution of a marriage (except to the extent that such proceedings seek determination of the division of property that is property of the estate), and domestic violence. §362(b)(2)(A).

Generally, the automatic stay goes into effect upon the filing of a bankruptcy petition. Absent a grant of relief, the stay remains operative from the filing of the bankruptcy petition until it statutorily terminates. However, whether the bankruptcy is the debtor's first, second or third filing within that year can determine how long the stay lasts.

III. Secured or Unsecured Creditor

The rights a creditor has depend on whether it is a secured or unsecured creditor. A creditor is secured to the extent it has a properly perfected security interest in the debtor's collateral. Examples include mortgages on real estate or a security interest in a vehicle, boat, goods or equipment. Creditors with secured claims typically have greater rights than unsecured creditors. However, all creditors have *some* general rights in a Chapter 7 bankruptcy case. Creditors are entitled to share in any payment from the bankruptcy estate according to the priority of their claim; to be heard by the court in matters dealing with the liquidation of the debtor's nonexempt assets and to challenge a debtor's right to a discharge or a discharge of the creditor's particular debt. Secured creditors are usually much better off than unsecured creditors. Secured creditors have a lien giving them specific rights to the collateral that is the security for their claim. In a

Chapter 7 bankruptcy, the debtor has three choices with respect to secured creditors: surrender, reaffirm or redeem.

IV. Statement of Intention and the Debtor's Choices for Secured Creditors

Upon the filing of a bankruptcy petition, the debtors will have to decide whether they can/want to keep their house or car loan. Within thirty days of filing the bankruptcy petition, or by the meeting of creditors, whichever occurs first, an individual Chapter 7 debtor is required to file a "Statement of Intention" indicating whether the debtor intends to retain or surrender secured or leased property. The time in which the debtor has to file the Statement of Intention may be extended by the bankruptcy court for cause.

The Debtor's Statement of Intention may simply state the debtor's intention to surrender the collateral and receive a discharge of personal liability of any deficiency. If the debtor intends to retain the secured property, the debtor must state one of three grounds for the retention: 1) redemption; 2) reaffirmation; or 3) claimed as exempt. If the secured property is leased, the debtor must state his or her intention to assume or reject the lease. Section 521(a)(2) states that the debtor "shall perform" the intention within thirty days of the first meeting of creditors. Unlike some other circuits which allow a debtor more flexibility, the Seventh Circuit has held that the options available to a debtor to retain secured property are limited to those contained in the official form: retain, redeem or seek voidance of the lien. **Matter of Edwards, 901 F.2d 1383 (7th Cir. 1990)**.

In some cases, the debtor may want to continue to use the collateral for as long as possible before being forced to surrender it. In other cases, the debtor may want to reaffirm the loan but has not received a reaffirmation agreement from the creditor. Under the reaffirmation statute, a debtor further has the right to cancel a reaffirmation agreement within 60 days after

signing, which places the debtor's final decision to reaffirm or surrender well outside the thirty day period provided by §521.

What consequence therefore does a debtor face for failing to perform the stated intention within the thirty day period? Illinois case law indicates that a debtor is not bound to follow through with the declaration made in the original Statement of Intention, and may later change his mind with no consequence other than the automatic stay lifting to allow the secured claim holder to recover the collateral. When faced with a debtor's delay in surrendering property, a bankruptcy court in the Northern District of Illinois explicitly stated that there is no statutory sanction for failing to comply with the thirty day deadline and noted that the statement of intention statute is a procedural notice provision rather than conferring rights to the creditor. **In re Irvine, 192 B.R. 920 (Bankr. N.D. Ill. 1996)**. Requests by secured creditors for sanctions for a debtor's non-performance of the stated intention, such as dismissal of the case or monetary penalties, have been uniformly denied by Illinois bankruptcy courts. **See e.g. In re Crooks, 148 B.R. 867 (Bankr. N.D. Ill. 1993)**. Outside of Illinois, some bankruptcy courts have found conduct by a debtor egregious enough to impose a sanction such as declaring the debt to be non-dischargeable, but these cases are in the minority. **See In re Bushey, 204 B.R. 661 (Bankr. N.D. N.Y. 1997)**; **C.f. In re Weir, 173 B.R. 682 (Bankr. E.D. Cal. 1994)** (referring to §521 as the Bankruptcy Code's "toothless tiger").

Under §362(h)(1)(B), "the stay provided by subsection [362](a) is terminated with respect to personal property of the estate or of the debtor securing in whole or in part a claim, or subject to an unexpired lease, and such personal property shall no longer be property of the estate if the debtor fails within the applicable time set by section 521(a)(2) to take timely the action specified in such statement, as it may be amended before expiration of the period for taking

action, unless such statement specifies the debtor's intention to reaffirm such debt on the original contract terms and the creditor refuses to agree to the reaffirmation on such terms." Therefore, if the debtor's Statement of Intention indicates that the debtor will redeem or avoid a lien on secured personal property -- or assume a personal property lease -- and the debtor has not performed the action within 30 days of the first meeting of creditors, the creditor may repossess the personal property collateral or begin a replevin action. Further, §362(h) also automatically abandons the collateral from the bankruptcy estate in such a circumstance providing complete relief. However, §362(h) is limited to personal property collateral; a holder of a lien on real property is still required to file a motion to lift the automatic stay if it wants to begin or resume a foreclosure proceeding prior to the entry of discharge.

In cases where the debtor's Statement of Intention indicates that he wants to reaffirm personal property, Section 362(h) creates uncertainty over the status of the automatic stay if a reaffirmation agreement is not filed within the thirty day period. A secured creditor could tender an original terms reaffirmation agreement to the debtor during the thirty day period, and then rely on the provision if the agreement is not returned. However, if the collateral is repossessed after the thirty day period, the debtor may argue that somehow the reaffirmation agreement tendered was not according to "original terms" and seek damages for violation of the stay. To proceed cautiously, it would be best to file a motion to lift the automatic stay in such circumstances if the creditor does not want to wait until discharge to act.

Section 362(h)(1)(B) provides for similar stay relief and abandonment of personal property collateral if the debtor fails to file a Statement of Intention within the thirty day time period required by §521(a)(2). However, the debtor not filing a statement is unlikely, the more likely situation is where there is a defect in the Statement of Intention filed by the debtor.

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V. Relief from the Automatic Stay

There are situations where a creditor can request that the bankruptcy lift or modify the automatic stay so that the creditor may proceed with a non-bankruptcy action. A request to modify or lift the stay is made by motion. The automatic stay can be modified for cause, including lack of adequate protection. In a Chapter 7 proceeding, the most important issue is whether there is equity in the property. Under 11 U.S.C. §362(d)(2) of the Code, grounds exist to grant relief from automatic stay if there is no equity in a property and it is not necessary for an effective reorganization. Since a Chapter 7 debtor is not attempting reorganization, the important issue is equity. If there is substantial equity in the property, the Chapter 7 trustee may attempt to sell the property. In the event such a sale occurs, the mortgages and other liens on the property would be paid out of the sale price and surplus funds would be paid to unsecured creditors after payment of the costs of sale. In most cases, there is not enough equity to interest the trustee and a no-asset report is filed. It must be noted that some Illinois bankruptcy judges will not modify the stay in a Chapter 7 proceeding prior to the first meeting of creditors (See 11 U.S.C. §341) without the agreement of the trustee. While there is no statutory requirement that the meeting be held prior to an order for relief from stay, these judges wish to offer the trustee an opportunity to interview the debtor at the meeting in order to make a more accurate determination as to the value of the property.

In addition, to default or lack of equity, the court may modify the stay if the creditors' interests are not adequately protected due to some other circumstance. 11 U.S.C. §362(d)(1). For instance, if the property is in danger due to lack of insurance, pending building court or demolition cases, or imminent tax sale: the court may modify the stay to allow a creditor to protect its interest in the property. This is the basis for relief in any type of bankruptcy.

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In some cases, the trustee will take the position that there is sufficient equity to sell the property. If this is the case, most judges will be generous in allowing time for the trustee to market the property-often either denying the creditor's motion to modify or continuing it for a lengthy period of time. Sometimes, the trustee will agree to enter the orders modifying the stay with a long effective date-for example, 90 days.

Some judges will deny motions for relief even if there is not sufficient equity to warrant a trustee sale if there is equity for the debtors. The theory behind this recent development has to do with grounds of relief under 11 U.S.C. §362(d)(a). Under this provision, one of the grounds for relief must be that "the debtor does not have any equity in such property."

Each District has local rules that must be reviewed and followed prior to proceeding with a motion to lift the stay. For example, in the Northern District of Illinois, at the time of filing the motion, the request must be accompanied by the Required Statement to Accompany All Motions for Relief from Stay, which is available at www.ilnb.uscourts.gov. Additionally, notice must be served on the debtor, debtor's attorney, the case trustee, and any party who has requested notice of proceedings. While sending notice directly to a debtor who is represented by counsel is contrary to most attorneys' notions of the law regarding contact with represented parties, it is required under the Federal Rules of Bankruptcy Procedure.

Once an order granting relief from the automatic stay is entered, there is an automatic 14-day waiting period before the creditor may act on the order, unless the waiting period is waived by the bankruptcy court. See Federal Rule of Bankruptcy Procedure 4001 (a)(3). Some judges will routinely waive the automatic 14 –day stay upon a creditor's request in its motion, provided there is no objection.

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VI. Reaffirmation

In some circumstances, a debtor may wish to pay debts that would otherwise be dischargeable. If the debtor and creditor are agreeable, they would enter into a reaffirmation agreement. A reaffirmation agreement typically incorporates all of the terms of the underlying agreement by the parties. A creditor needs a valid reaffirmation agreement if it wants to retain a legal right to enforce a debt that would otherwise be dischargeable by the Chapter 7 debtor. If a debt is "reaffirmed", pursuant to the requirements of §524(c), the discharge the debtor receives in the Chapter 7 case will not protect the debtor from personal liability on the loan after the bankruptcy. If the reaffirmed loan is secured by property, which is repossessed or foreclosed after bankruptcy, a personal deficiency may be enforced against the debtor.

The reaffirmation agreement form requires multiple "parts" containing various disclosures and budget calculations, both by the debtor and the creditor. If any of these required elements and disclosures are not completed, the agreement may not be enforceable later. The official reaffirmation agreement forms and required coversheet are available for download through all three Illinois bankruptcy court websites.

A reaffirmation agreement is an "agreement" meaning that both parties must consent to its terms and filing with the bankruptcy court. Neither a creditor nor the debtor may create and file a unilateral reaffirmation agreement without the consent of the other party. **In re Turner, 156 F.3d 713 (7th Cir. 1998)**. Even if the debtor desires to reaffirm a debt, a creditor cannot be compelled to enter into a reaffirmation agreement. **In re Amoakohene, 299 B.R. 196 (Bankr. N.D. Ill. 2003)**. The reaffirmation agreement must also be signed and filed before discharge. See **In re Connie S. Golladay, 391 B.R. 417 (Bankr. C.D.Ill. 2008)**. A reaffirmation agreement is only valid if it is filed with the court.

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A debtor has the right to cancel (or in bankruptcy terms "rescind") a reaffirmation agreement after its filing with the court, subject to certain time limits and notice requirements contained in §524(c)(4). A debtor can rescind a reaffirmation agreement either 1) within sixty days after the agreement is filed with the court or 2) prior to entry of the discharge order, whichever occurs *later*. If the debtor chooses to rescind the reaffirmation agreement he must give notice to the creditor of the rescission, and the notice should also be filed with the bankruptcy court so there is no doubt as to when the right to rescind was exercised.

In some cases, a debtor may want to keep and continue to pay on a secured loan, but either the creditor refuses to reaffirm, or for whatever reason, a timely reaffirmation agreement is not filed. The "fourth option" of retaining but not reaffirming on a secured loan is not supposed to be available to Illinois debtors. In practice however, the debtor in these situations generally continues to make, and the creditor continues to accept, payments on the loan despite the absence of a reaffirmation agreement.

VII. Redemption

Under §722, redemption is the statutory right of a debtor to free personal property collateral from a secured lien for less than the full balance. The redemption option is available only to individual Chapter 7 debtors.

A debtor may redeem only "tangible" personal property. Intangible property such as a stock or life insurance policies do not qualify for bankruptcy redemption. A debtor may not redeem real property such as a home; however, fixtures such as siding and windows have been found to be redeemable under §722 by courts outside Illinois. **In re Walker, 173 B.R. 521 (Bankr. M.D. N.C. 1994)**. In Illinois, a mobile home is considered personal property and redemption is permissible. **In re Davis, 20 B.R. 212 (C.D. Ill. 1982)**.

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In order to be redeemable, property must be intended primarily for "personal, family or household use." **11 U.S.C. §722**. The analysis centers around the debtor's initial purpose in acquiring the property. If the debtor originally acquired the property for a business venture or with a profit/income production motivation, it is not redeemable. Additionally, in order to be redeemable, the debt underlying the lien must be a "consumer debt" and must be dischargeable.

Under §722, a debtor is able to "redeem" collateral from a second lien interest where the first lien exceeds the redemption value of the property - stripping off the lien for no payment other than the transaction cost to release the lien. **In re Williams, 228 B.R. 910 (Bankr. N.D. Ill. 1999)**.

In order to redeem property, a debtor is required to file a motion with the bankruptcy court. Also, in order for a debtor to exercise his or her redemption rights, the property must either be exempted by the debtor or abandoned by the trustee. Neither §722 nor Bankruptcy Rule 6008 contain a time deadline for a debtor to redeem property. Despite the challenges of creditors, bankruptcy courts have generally allowed a debtor to redeem property after the expiration of the thirty day intention period contained in §521. **In re Rodgers, 273 B.R. 186 (Bankr. C.D. Ill. 2002)**. Under the 2005 amendments, a creditor now may have automatic stay relief and abandonment if the debtor has stated the intention to redeem personal property but has not done so within the thirty days. Under prior law, it was unclear whether a debtor could, through the filing of a redemption motion, stop liquidation of collateral after the lifting of the stay and abandonment. **See In re Smith, 313 B.R. 785, 793-94 (Bankr. N.D. Ind. 2004)**. However, amended §521 states that the only relief available to a creditor for debtor's failure to timely perform the intentions is stay relief and not the loss of any other rights. 11 U.S.C. §521(a)(2)(C).

Upon the entry of the redemption order, the debtor is required to pay the required

amount "in full at the time of redemption." **11 U.S.C. §722**. The amount must be paid in one lump sum payment, and not through installments over time. Upon payment of the redemption amount, the order usually includes language requiring the release of the subject lien.

Under §506(a)(2), allowed secured claims against personal property of Chapter 7 debtors is set at "replacement" value on the date of the bankruptcy petition, without deduction of costs for sale or marketing, regardless of the section of the Bankruptcy Code involved. Replacement value of property "acquired for personal, family, or household purposes" is further defined by §506(a)(2) as "the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined." **In re Redpath, 2009 WL 3242107 (Bankr. C.D. Ill. 2009)**.

Thus, the valuation for redemption in Chapter 7 cases is now essentially the same as the valuation standard for personal property crammed down to value under a Chapter 13 plan. Where redemption value is disputed, each party must retain an expert witness with experience in sale of the category of property being valued and apply the "replacement value" definition to the property. However, in practice, it is too costly to hire an expert witness given the property values involved. Therefore, courts often rely on national guides, when available, in setting the value. For vehicles, Illinois courts commonly use the N.A.D.A. (National Auto Dealers Association) retail value often with varying deductions. **See In re McElroy, 339 B.R. 185 (Bankr. C.D. Ill. 2006)** (holding that N.A.D.A. retail minus 5% was appropriate); **In re Gonzalez, 295 B.R. 584 (Bankr. N.D. Ill. 2003)** (using N.A.D.A. retail with deductions for mileage, condition and other costs was appropriate).

VIII. Discharge, Dischargeability and Nondischargeable Debts

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One of the goals of bankruptcy is to give the honest but unfortunate debt a fresh start by relieving them of their personal liability for debts incurred prior to the filing for bankruptcy relief. A discharge absolves the debtor of its obligation to pay certain debts arising before the filing of the petition. The order of discharge also operates as an injunction against the commencement or continuation of a case to collect on a debt, and voids any judgment against the debtor entered in connection with a debt that has been discharged. The effect and availability of discharge is different for each chapter.

A debtor's right to a discharge may be affected in two ways: a creditor may claim that its particular debt should be excluded from the discharge or the debtor may be using the bankruptcy process for an improper purpose or may be acting dishonestly in the conduct of the bankruptcy case and there may be grounds to deny the debtor's discharge completely.

If a creditor claims that the debtor performed some bad act toward the creditor while incurring the debt and that the act should cause the debt to be excluded from the debtor's discharge, the creditor is claiming that this particular debt is nondischargeable. There are also types of debts that are nondischargeable for public policy reasons. Exceptions to discharge are found in 11 U.S.C. §523.

Nondischargeability of a particular debt and denial of a debtor's discharge are two distinct actions that may be brought by a creditor in an adversary proceeding. These types of proceedings are often complex and should be handled by an experienced bankruptcy practitioner.

IX. Steps from Creditor's Perspective

- Upon receipt of a bankruptcy notice, immediately stop any and all actions relating to collection or foreclosure activities.
- Update your case management system with the bankruptcy information.

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- Inform/notify attorney handling collection or foreclosure action.
- Verify/check if the debtor intends to reaffirm, surrender or redeem.
- If proceeding with reaffirmation, prepare and send a completed reaffirmation to debtor's attorney to be executed, signed and returned prior to the discharge date for filing. Only use official reaffirmation agreement and coversheet forms that are available on the Bankruptcy Court websites.
    - Supporting documents and information needed for drafting and filing reaffirmation agreement are: loan documents (note, mortgage and any loan modification or contract and title to automobile), monthly payment amount, total amount outstanding on the note (before bankruptcy and under reaffirmation agreement), date first payment is due under the reaffirmation agreement, the number of months until maturity and applicable interest rate (before bankruptcy and under reaffirmation agreement).
- If debtor intends to surrender, proceed with a Motion for Relief or in the alternative wait for discharge of debtor and a no asset report by the trustee prior to proceeding with state law remedies to recover your collateral.
    - Supporting documents and information needed to proceed with a motion for relief: loan documents (note, mortgage and any modifications or contract and title), default broken down by month and amount and amount outstanding on the note.
- File proof of claim for any deficiency after the sale of security interest provided that you receive notice from the bankruptcy court requesting the filing of a proof of claim as the trustee has discovered assets that are available for distribution to unsecured creditors.

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- If the debtor files a Motion to Redeem and the redemption value is not acceptable, ensure a timely response/objection is filed.
    - Supporting documents and information needed to file a response: valuation.
- Upon receipt of a discharge order, appropriately notate your case management system that the debtor is no longer personally liable for the debt, providing a valid reaffirmation agreement has not been filed and not rescinded.

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Faculty

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Hon. Michael A. Fagone is a U.S. Bankruptcy Judge for the District of Maine in Bangor, appointed in April 2015. He is also a member of the U.S. Bankruptcy Appellate Panel for the First Circuit, appointed in April 2016. Judge Fagone previously clerked for Associate Justices Leigh I. Saufley and Robert W. Clifford of the Maine Supreme Judicial Court. Following his clerkship, he joined Bernstein, Shur, Sawyer & Nelson in Portland, Maine, and was a member of its Business Restructuring and Insolvency Practice Group from 1998-2000, and from 2001-15, where he represented clients in bankruptcy cases and in out-of-court restructurings. While practicing law, Judge Fagone was recognized in *The Best Lawyers in America* and *Chambers USA* as one of the top bankruptcy lawyers in Maine. He is Board Certified in Business Bankruptcy Law by the American Board of Certification and served on the board of directors of the Nathan and Henry B. Cleaves Law Library, and on the board of directors of the Dyer/Library and Saco Museum. Judge Fagone currently serves on ABI's Board of Directors and volunteers with Credit Abuse Resistance Education (CARE), teaching students about the responsible use of credit and the dangers of credit abuse. He also has volunteered as a coach and an evaluator for Maine Law's teams in the Conrad B. Duberstein Moot Court Competition. Judge Fagone received his B.A. from Amherst College in 1993 and his J.D. *summa cum laude* from the University of Maine School of Law in 1997.

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