

BANKRUPTCY BASICS

THE CREDITOR'S PERSPECTIVE

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I. Overview of the Bankruptcy Chapters

- A. Chapter 7: Liquidation or "Straight Bankruptcy"
 - 1. Surrender assets to trustee
 - 2. Get a discharge
 - 3. 90% of assets are exempt anyway
 - 4. Pro-rata distribution to creditors. Example: \$5,000 in assets; Creditor A owed \$5,000; Creditor B owed \$10,000; Creditor C owed \$15,000. Creditor A gets 1/6 of \$5,000; Creditor B gets 1/3 of \$5,000 and Creditor C gets 1/2 of \$5,000.
 - 5. Reaffirmation, surrender, redemption or ride-through
- B. Chapter 13: Wage earner plan
 - 1. Only available to individuals
 - 2. Buy back assets from trustee through future earnings
 - 3. Regular income, and debts cannot exceed specified amounts
 - 4. Propose plan, get confirmation, pay trustee
 - 5. 50% of confirmed plans don't complete, and many more don't get confirmed
- C. Chapter 12 Family farmer
- D. Chapter 11
 - 1. Available to all filers: individuals, corporations, LLCs, etc.
 - 2. Very complex and expensive
 - 3. Creditors have input into the plan
 - 4. Concept of Debtor in Possession (DIP)
 - 5. Plan and disclosure statement
 - 6. Single Asset Real Estate entitled (SAREs)

II. The Automatic Stay, Section 362 of the Bankruptcy Code

- A. What it covers
 - 1. the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
 - 2. The enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
 - 3. any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
 - 4. Any act to create, perfect, or enforce any lien against property of the estate;

- 5 any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
 6. Any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
 - 7 the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and
 - 8 the commencement or continuation of a proceeding before the United States Tax Court concerning a corporate debtor's tax liability for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.
- B. What it doesn't cover
1. Criminal proceedings
 2. Actions to determine paternity
 3. Divorce proceedings, except to the extent of division of property
 4. Child custody
 5. Domestic support obligations
- C. Relief from the automatic stay, section 362(d)
1. Relief is not always termination. Can be modification or conditioned upon
 2. In Chapter 7
 - a. Subject to trustee's abandonment
 - b. If debtor doesn't surrender
 - c. If collateral is unprotected, e.g., uninsured
 - d. Default in payments after/pending reaffirmation
 3. In Chapter 13
 - a. Very difficult if debtor is paying
 - b. Default in plan payments
 - c. Unprotected collateral
- D. In Chapter 11
1. Sometimes is the key
 2. SARE cases Section 362(d)(3)(B)
 3. Common issues
 - a. Does the debtor have equity (equity cushion)?
 - b. Is the property necessary to an effective reorganization?
 - c. Can the creditor be provided with adequate protection?
- E. Relief from stay in medical malpractice cases

III. Treatment of Cars and Homes in Chapter 13

- A. Section 506 and the concept of cram down
- B. No cram down of mortgages secured by the debtor's primary residence
- C. Treatment of delinquent mortgage payments
- D. Car loans pre-BAPCPA
 1. Bifurcation of claim into secured and unsecured parts
 2. Subordinated to administrative claims (trustee's fee, attorney's fees)

3. Months could pass without any payments
 4. No provision for adequate protection
- E. Car loans post-BAPCPA
1. Section 1326(a)(1) provides some adequate protection to PMSI security interests
 2. What is a PMSI? State law governs. UCC 9-103(h)
 3. Section 1325(a)(5) has a more classic view of adequate protection
 4. Valuation. What is being protected? Collateral value, not the right to payment. Becomes important in 910-day vehicle cases
- F. The infamous "changing paragraph" of section 1325(a)*
1. Bifurcation under section 506 does not apply to a PMSI for a debt incurred within 910-days of filing of the collateral is a motor vehicle as defined in 49 U.S.C. §30102 acquired for personal use of the debtor.
 2. Must pay the debt in full (including financing costs, negative equity, maintenance contracts included as part of the financing arrangement). See In re: Burt. However, can modify the terms.
 3. Cannot surrender the car in full satisfaction of the debt. See In re: Ballard.

IV. Lien Avoidance

- A. Preferential liens
1. Section 547 ó trustee's avoiding powers
 2. Example: Same \$5,000 and three creditors, except in this case Creditor A was either paid voluntarily or seized through court process the \$5,000 in assets within 90 days of the debtor filing. Trustee will set aside the transfer and divide the \$5,000 as before.
 3. Same result as to judgment liens that are recorded within 90 days.
- B. Liens that impair exemptions See In re: Cozad, 208 B.R. 495
1. Facts: House worth \$96,000. Jointly owned by debtor and his non-filing wife. First mortgage of \$42,000; IRS lien of \$3,800; judgment of \$77,000. Debtor claimed \$11,000 homestead exemption.
 2. What the creditor wanted:

Fair market value of house	\$96,000
LESS mortgage	<u>\$42,000</u>
Net equity	\$54,000

Debtor's one-half interest	\$27,000
LESS homestead exemption	\$11,000
LESS IRS lien	<u>\$ 3,800</u>
Remaining judgment lien	\$12,200

3. What the debtor argued and court did. Section 522(f) is not ambiguous: For the purposes of this subsection, a lien shall be considered to impair an exemption to the extent that the sum of--

- (i) the lien;
- (ii) all other liens on the property; and
- (iii) the amount of the exemption that the debtor could claim if there were no liens on the property;

exceeds the value that the debtor's interest in the property would have in the absence of any liens.

Debtor's one-half interest	\$ 48,000
Total of all liens and exemption	\$133,800
Difference	(\$85,800)

Because there was nothing above the sum of the liens and exemption, the lien impaired the exemption and was avoided in its entirety.

C. "Secret" liens

1. Creditor fails to perfect. See UCC 9-317(a)(2): A judgment lien has priority over a security interest for which no public notice was given
2. Section 544 permits avoidance of such liens altogether, even absent a judgment lien
3. Section 547(b), (e)(1) and (e)(2) permit avoidance of liens not perfected within 10 days after granting the security interest and within 90 days prior to filing.

V. **Objecting to Discharge**

A. Objecting to discharge of certain debts, section 523

1. False pretenses, false representations or actual fraud
2. Use of a writing that is materially false respecting the debtor's financial condition, on which the creditor relied, and that the debtor caused to be made with intent to deceive
3. Did the dishonest conduct *create* the debt or did it occur after the debt?
4. Non-support domestic obligations, section 523(a)(15)
5. Check to determine whether an adversary proceeding is necessary

B. Objecting to discharge in general, section 727

1. Debtor took actions to hinder, defraud or delay a creditor or officer of the case (trustee, judge, etc.)
2. Concealed, destroyed, falsified, mutilated books or records
3. Fraudulently made a false oath or claim in the case
4. Generally refused to cooperate in the administration of the case

TABLE OF DISCHARGEABLE DEBTS

Dischargeable	Possibly dischargeable	Not dischargeable
<ul style="list-style-type: none"> • Personal loans • Credit cards • Repossession deficiencies • Auto accident claims • Medical bills • Judgments • Business debts • Leases • Guaranties • Negligence claims • Tax penalties over 3 years old • Income taxes that aren't priority taxes 	<ul style="list-style-type: none"> • Willful and malicious injuries to others • Embezzlement • Debts incurred by fraud or dishonesty • Debts arising from breach of fiduciary duty <p style="text-align: center;">A creditor contesting the discharge of these debts must take prompt action to contest the discharge of his claim.</p>	<ul style="list-style-type: none"> • Recent taxes • Trust fund taxes • Child or family support • Criminal fine or restitution • Accident claims involving intoxication • Debts not scheduled • Penalties payable to the government other than tax penalties • Student loans • Debts listed in prior bankruptcy where debtor was denied a discharge • Taxes for years where return unfiled or filed for less than 2 years