

BANKRUPTCY OVERVIEW

Article I of the Constitution empowers Congress to “establish uniform laws on the subject of bankruptcies throughout the United States.” For most of the 20th Century, bankruptcy law was the Bankruptcy Act of 1898. It was replaced in 1978 by a law commonly referred to as “Bankruptcy Code,” which has been regularly amended, with a comprehensive set of amendments enacted in 2005.

The Code itself contains mainly matters of substance; procedure is governed by a separate package of Bankruptcy Rules. The bankruptcy law statutes and rules are highly interrelated; so many sections are understandable only in the context of the overall Bankruptcy Code.

Further, although the law is federal, many aspects of state law apply in that the bankruptcy courts look to state law to determine questions such as (1) what are the property rights of the debtor, (2) what are the claims of the creditors to the property, (3) which exemptions and dollar amounts apply [i.e. what the debtor may keep for his/her fresh start], and (4) which statute of limitations will apply to various situations.

There are two general forms of bankruptcy relief: (1) liquidation and (2) rehabilitation or reorganization. There are five separate kinds of bankruptcy cases, but this class will address the three most commonly used.

1. Liquidation

Chapter 7 is entitled “liquidation.” The title is descriptive. In a Chapter 7 case, the trustee collects the nonexempt property of the debtor, converts that property to cash, and distributes the cash to the creditors. The debtor gives up all of the nonexempt property he/she owns at the time of the filing of the bankruptcy petition in the hope of obtaining a discharge. A discharge releases the debtor from any further personal liability for the prebankruptcy unsecured debts.

Example: Debtor owes an unsecured Creditor \$ 2,000.00. Debtor files a Chapter 7 petition. Creditor only receives \$ 300.00 from the liquidation of debtor’s assets. If debtor receives a bankruptcy discharge, creditor will be precluded from pursuing debtor for the remaining \$ 1,700.00.

Secured debt is debt for which a creditor has a right to take a particular item if the debt is not paid, such as a car or house if the note or mortgage is not paid. The rights of secured creditors are affected by a bankruptcy proceeding [usually as to time, only] but the debt is not eliminated, just postponed.

As the preceding paragraph implies, every Chapter 7 case under the bankruptcy law does not result in a discharge. Section 727(a) lists a number of grounds for withholding a discharge [i.e., fraud, concealment of assets, violation of court order, prior bankruptcy within certain time limits]. And, even if the debtor

is able to obtain a discharge, he/she will not necessarily be freed from all creditors' claims. Section 523 sets out 19 categories of exceptions to discharge.

The vast majority of bankruptcy cases are Chapter 7 cases. The term "bankruptcy" is often used to describe liquidation proceedings under the bankruptcy laws.

2. Reorganization

Chapters 11 and 13 generally deal with debtor rehabilitation or reorganization of the debtor's financial affairs, not liquidation of the debtor's assets. In a Chapter 11 or 13 case creditors usually look to future earnings of the debtor, not the property of the debtor at the time of the initiation of the bankruptcy proceeding, to satisfy their claims. The debtor retains its assets and makes payments to creditors, usually from post petition earnings [earned after filing of case], pursuant to a court approved plan.

Chapter 11, like Chapter 7, is available to all forms of debtors – individuals, partnerships and corporations (though individuals infrequently use Chapter 11 because the process is so complex and costly). Chapter 13 can be used only by individuals with a "regular income" (as defined in Section 101(30)) who have unsecured debts of less than \$336,900 and secured debts of less than \$1,010,650. [These numbers, and other numbers under the Bankruptcy Code, are adjusted periodically pursuant to section 104.]

With the 2005 amendments, Congress added a "means test" which can be used to force a debtor into a Chapter 13 rather than allowing a Chapter 7 liquidation. Congress has chosen to force debtors to pay more of their debts.

Unlike most of your other classes, this one is statute number intensive and lawyers and judges in the field refer to concepts by their numbers.