

The Influence of Bankruptcy on Collections: Overview of Bankruptcy Chapters

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I. OVERVIEW OF THE BANKRUPTCY CHAPTERS

A. Brief history of Bankruptcy:

The concept of bankruptcy is one which predates even the founding of our country. The notion of getting relief from one's debts can be traced back to English common law; however, the first codification of it under US law can be seen in our Constitution. Article I, Section 8, of the US Constitution grants to Congress the power to establish "uniform Laws on the subject of Bankruptcies throughout the United States." Since then Congress has had numerous iterations of bankruptcy law, going through numerous reforms, all seeking to strike a balance between the interests of debtors and creditors.

According to the United States Supreme Court "a central purpose of the [Bankruptcy] Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." *Local Loan Co. v. Hunt*, 292 U.S. 234, 244, 78 L. Ed. 1230, 54 S. Ct. 695 (1934)." *Grogan v. Garner*, 498 U.S. 279 (1991). This purpose, however, of providing a "fresh start" is for the honest but unfortunate debtor and, as we will discuss later, and does not extend to a dishonest debtor seeking to use the Bankruptcy Code as a shield to avoid paying their creditors.¹

B. Key Terms and Concepts in Bankruptcy

Courtesy of the United States government² the foregoing is a list of key terms and concepts which would be helpful to know when trying to navigate through a bankruptcy.

A

adversary proceeding - a lawsuit arising in or related to a bankruptcy case that is commenced by filing a complaint with the court. A nonexclusive list of adversary proceedings is set forth in Fed. R. Bankr. P. 7001.

Assume/assumption - an agreement to continue performing duties under a contract or lease.

automatic stay - an injunction that automatically stops lawsuits, foreclosures, garnishments, and all collection activity against the debtor the moment a bankruptcy petition is filed.

B

¹ *Stewart Title Guar. Co. v. Roberts-Dude*, 497 B.R. 143, 150 (S.D. Fla. 2013); *Posillico v. Bratcher (In re Bratcher)*, 289 B.R. 205, 213 (Bankr. M.D. Fla. 2003); *Royer v. Smith (In re Smith)*, 278 B.R. 253, 257 (Bankr. M.D. Ga. 2001)." *Eastern Diversified Distribs., Inc. v. Matus (In re Matus)*, 303 B.R. 660, 670 (Bankr. N.D. Ga. 2004).

² <http://www.uscourts.gov/educational-resources/educational-activities/bankruptcy-basics-glossary>

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 U.S. 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. Compare U.S. trustee.

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 petition - the document filed by the debtor (in a voluntary case) or by creditors (in an involuntary case) by which opens the bankruptcy case. (There are official forms for bankruptcy petitions which are generally available at the website for the court where you are trying to file.)

C

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 9 - the chapter of the Bankruptcy Code providing for reorganization of municipalities (which includes cities and towns, as well as villages, counties, taxing districts, municipal utilities, and school districts).

chapter 11 - the chapter of the Bankruptcy Code providing (generally) for reorganization, 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," or a "family fisherman" as those terms are 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 15 - the chapter of the Bankruptcy Code dealing with cases of cross-border insolvency.

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

confirmation - bankruptcy judges' approval of a plan of reorganization or liquidation in chapter 11, or payment plan in chapter 12 or 13.

consumer debtor - a debtor whose debts are primarily consumer debts.

consumer debts - debts incurred for personal, as opposed to business, needs. This might be important when determining whether a debtor may be required to file a chapter 13 case as opposed to chapter 7

contested matter - those matters, other than objections to claims, that are disputed but are not within the definition of adversary proceeding contained in Rule 7001.

contingent claim - a claim that may be owed by the debtor under certain circumstances, e.g., where the debtor is a cosigner on another person's loan and that person fails to pay.

creditor - one to whom the debtor owes money or who claims to be owed money by the debtor.

credit counseling - generally refers to two events in individual bankruptcy cases: (1) the "individual or group briefing" from a nonprofit budget and credit counseling agency that individual debtors must attend prior to filing under any chapter of the Bankruptcy Code; and (2) the "instructional course in personal financial management" in chapters 7 and 13 that an individual debtor must complete before a discharge is entered. There are exceptions to both requirements for certain categories of debtors, exigent circumstances, or if the U.S. trustee or bankruptcy administrator have determined that there are insufficient approved credit counseling agencies available to provide the necessary counseling.

creditors' meeting - see 341 meeting

current monthly income - the average monthly income received by the debtor over the six (6) calendar months before commencement of the bankruptcy case, including regular contributions to household expenses from nondebtors and income from the debtor's spouse if the petition is a joint petition, but not including social security income and certain other payments made because the debtor is the victim of certain crimes. 11 U.S.C. § 101(10A).

D

debtor - a person who has filed a petition for relief under the Bankruptcy Code.

debtor in possession - a debtor in possession occurs only in a Chapter 11 case, whereby the debtor is presumed to remain in possession of its assets and business operation, with most of the powers and duties of a trustee.

defendant - an individual (or business) against whom a lawsuit is filed.

discharge - a release of a debtor from personal liability for certain dischargeable debts set forth in the Bankruptcy Code. (A discharge releases a debtor from personal liability for certain debts known as dischargeable debts and prevents the creditors owed those debts from taking any action against the debtor 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. There are certain debts which generally cannot be discharged – like student loans or alimony and other which the creditor must specifically assert should not be discharged. We will discuss those later.

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.

E

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 \$100,000 is subject to a \$80,000 mortgage, there is \$20,000 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 or bankruptcy trustee, if applicable, may assume it or reject it. The creditor may also seek the debtor be required to assume or reject a contract. If assumed the contract must be brought and all regular monthly payments resumed.)

exemptions, exempt property - certain property owned by an individual debtor that the Bankruptcy Code or applicable state law permits the debtor to keep from unsecured creditors. For example, in some states the debtor may be able to exempt all or a portion of the equity in the debtor's primary residence (homestead exemption), or some or all "tools of the trade" used by the debtor to make a living (i.e., auto tools for an auto mechanic or dental tools for a dentist). The availability and amount of property the debtor may exempt depends on the state the debtor lives in.

H

homestead – that portion of equity in a debtor's primary residence which the debtor may claim as exempt from disposition by his or her unsecured creditors.

I

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 a 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.

J

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

joint petition - one bankruptcy petition filed by a husband and wife together.

L

lien - the right to take and hold or sell the property of a debtor as security or payment for a debt or duty.

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.

M

means test - Section 707(b)(2) of the Bankruptcy Code applies a "means test" to determine whether an individual debtor's chapter 7 filing is presumed to be an abuse of the Bankruptcy Code requiring dismissal or conversion of the case (generally to chapter 13). Abuse is presumed if the debtor's aggregate current monthly income (see definition above) over 5 years, net of certain statutorily allowed expenses is more than (i) \$12,850, or (ii) 25% of the debtor's nonpriority unsecured debt, as long as that amount is at least \$7,700. The debtor may rebut a presumption of abuse only by a showing of special circumstances that justify additional expenses or adjustments of current monthly income.

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

N

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. Examples may include a home mortgage if the debtor wants to keep the property, debts for alimony or child support, certain taxes, 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. Some debts, such as debts for money or property obtained by false pretenses and debts for fraud or defalcation while acting in a fiduciary capacity may be declared nondischargeable only if a creditor timely files and prevails in a nondischargeability action.

O

objection to dischargeability - a trustee's or creditor's objection to the debtor being released from personal liability for certain dischargeable debts. Common reasons include allegations that the debt to be discharged was incurred by false pretenses or that debt arose because of the debtor's fraud while acting as a fiduciary.

objection to exemptions - a trustee's or creditor's objection to the debtor's attempt to claim certain property as exempt from liquidation by the trustee to creditors.

P

party in interest - a party who has standing to be heard by the court in a matter to be decided in the bankruptcy case. The debtor, the U.S. trustee or bankruptcy administrator, the case trustee and creditors are parties in interest for most matters.

petition preparer - a business not authorized to practice law that prepares bankruptcy petitions.

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 the 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.)

preference or 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. There is a threshold amount and there are also certain defenses to claims of preference which may apply.

presumption of abuse - see the means test

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. For example, under the Bankruptcy Code's priority scheme, money owed to the case trustee or for prepetition alimony and/or child support must be paid in full before any general unsecured debt (i.e. trade debt or credit card debt) is paid.

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 and verifying documentation filed by a creditor that describes the reason the debtor owes the creditor money. (There is an official form for this purpose.)

property of the estate - all legal or equitable interests of the debtor in property (real or personal) as of the commencement of the case.

R

reaffirmation agreement - an agreement by a chapter 7 debtor to continue paying an otherwise dischargeable debt (such as an auto loan) after the bankruptcy, usually for the purpose of keeping collateral (i.e. the car) that would otherwise be subject to repossession.

relief from stay – before a creditor may seek to take any action against a debtor or the assets of debtor which are a part of the property of the estate, even if they have a security interest, the creditor must petition the bankruptcy court for relief from the automatic stay.

S

schedules - detailed lists filed by the debtor along with (or shortly after filing) the petition showing the debtor's assets, liabilities, and other financial information. (There are official forms a debtor must use.)

secured creditor - a creditor holding a claim against the debtor who has the right to take and hold or sell certain property of the debtor in satisfaction of some or all of the claim.

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. Examples include home mortgages, auto loans and tax liens.

small business case - a special type of chapter 11 case in which there is no creditors' committee (or the creditors' committee is deemed inactive by the court) and in which the debtor is subject to more oversight by the U.S. trustee than other chapter 11 debtors. The Bankruptcy Code contains certain provisions designed to reduce the time a small business debtor is in bankruptcy.

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.

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.)

T

341 meeting - the meeting of creditors required by section 341 of the Bankruptcy Code at which the debtor is questioned under oath by creditors, a trustee, examiner, or the U.S. trustee about his/her financial affairs. Also called creditors' meeting.

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 U.S. trustee or bankruptcy administrator. The trustee is a private individual or corporation appointed in all chapter 7, chapter 12, and chapter 13 cases and some chapter 11 cases. The trustee's responsibilities include reviewing the debtor's petition and schedules and bringing actions against creditors or the debtor to recover property of the bankruptcy estate. In chapter 7, the trustee liquidates property of the estate, and makes distributions to creditors. Trustees in chapter 12 and 13 have similar duties to a chapter 7 trustee and the additional responsibilities of overseeing the debtor's plan, receiving payments from debtors, and disbursing plan payments to creditors.

U

U.S. 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. Compare, bankruptcy administrator.

undersecured claim - a debt secured by property that is worth less than the full amount of the debt.

unliquidated claim - a claim for which a specific value has not been determined.

unscheduled debt - a debt that should have been listed by the 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.

V

venue – the location of the courthouse where a case is heard in. For a bankruptcy case, venue typically lies in the district in which the debtor resides

voluntary transfer - a transfer of a debtor's property with the debtor's consent.

C. Chapter 7, 13, and 11 Basics

Chapter 7:

Chapter 7 is the most common type of bankruptcy filing in the U.S. It provides for the liquidation of the debtor's assets to be applied to its debts. A trustee is appointed to take control of the property of the estate, liquidate the estate, and distribute the proceeds pro-rata to the creditors. Additional powers and duties of the trustee include the right to object to claims, investigate the affairs of the debtor, file lawsuits on behalf of the estate, and oppose the debtor's discharge. 11 USC § 704. A bankruptcy court may authorize a Chapter 7 trustee to continue the debtor's business to increase the return to creditors but this is not common. 11 USC § 721.

The debtor's typical motivations for filing a Chapter 7 case are to stop collection efforts, retain exempt property, and receive a discharge of its debts. The Chapter 7 discharge releases individual debtors from personal liability for most debts and prevents creditors from taking any collection actions against the debtor. As discussed in more detail later in these materials, some debts are excepted from Chapter 7 discharge. An individual debtor will receive a discharge within 60 to 90 days from the date first set for the meeting of creditors. Non-individual debtors do not receive a discharge and are simply dissolved.

Asset v. No Asset Cases. The trustee's role in a Chapter 7 case is to administer the case, take control of the assets and liquidate the debtor's non-exempt assets. 11 USC § 701, 704. In a case where non-exempt assets exist, it is the trustee's duty to liquidate the assets in a manner that maximizes the return to the unsecured creditors and sell any non-exempt property if it is free and clear of liens (or if sufficient equity exists.) The trustee may attempt to recover money or assets under the trustee's avoiding powers. The trustee is granted the power to set aside preferential transfers made to creditors within 90 days before the petition and undo security interests and other

pre-petition transfers of property not properly perfected at the time of the petition. They may also pursue claims such as fraudulent conveyances available under state law and may pursue any lawsuits or causes of action the debtor possesses at the time the case is filed.

In order to participate in any distribution by the trustee, the creditor will need to file a proof of claim in the case. If the case was filed as an asset case, a notice will typically go out to creditors advising of a date 90 days from the creditors meeting by which a creditor must file a claim. If a case is filed as a no asset case, but assets are later discovered, a notice will be entered setting a deadline by which claims must be filed. A creditor must file its claim by this deadline in order to participate in any distribution. A secured creditor, however, does not forfeit its security interest or lien by failing to file a claim.

Most Chapter 7 cases filed on behalf of individuals, however, are no asset cases. If the debtor lists no non-exempt assets in its schedules, and it appears that there are no additional assets at the conclusion of the meeting of creditors, the trustee will file a "no asset" report with the court. In these cases, there will be no distribution to the creditors and the debtor is typically awarded a discharge shortly after the report is filed.

Chapter 13

Chapter 13 provides for the readjustment of the debts of individuals with regular income. The purpose of Chapter 13 is for the debtor to be able to submit a plan and have it confirmed by the court that commits some portion of the debtor's future income to pay creditors for either three or five years. The Chapter 13 trustee oversees the administration of the bankruptcy case, confirmation, and execution of the Chapter 13 plan through receiving and disbursing the debtor's monthly payments, but does not have the same responsibilities as a Chapter 7 trustee. The debtor

remains in possession and control of the bankruptcy estate and can exercise some, but not all, of the powers of a Chapter 7 trustee. To be eligible for Chapter 13, an individual must have less than \$336,900.00 of unsecured debt and less than \$1,010,650.00 in secured debt. 11 USC § 109(e).

Chapter 13 offers individuals with substantial assets an advantage over liquidation under Chapter 7. The debtor has the opportunity to save its home from foreclosures and vehicles from repossessions. The delinquencies on these loans can even be cured over time. A debtor can also reschedule secured debts (other than a mortgage on the debtor's primary residence) and extend the payments over the life of the Chapter 13 plan. This allows the debtor to lower the payments. Also, debtor may alter the interest rate on debts other than mortgage debt.

An individual cannot file a Chapter 13 case if, during the preceding 180 days, a prior bankruptcy was dismissed due to the debtor's willful failure to comply with orders of the court or was voluntarily dismissed after a creditor sought relief to recover its collateral. A Chapter 13 debtor must also receive credit counseling within 180 days prior to filing.

Means Test: Certain individuals may not qualify to file a petition under Chapter 7, and will be forced to have their case converted to a Chapter 13 case or dismissed under §707. These are generally individuals with the majority of their debt being consumer debt and that have incomes exceeding the applicable median income of a family of their size in their geographic area. This test is generally referred to as the bankruptcy "means test." Under §704(b) and (c), a debtor is required to provide certain financial information to the trustee and a determination will be made and provided to the court as to whether the debtor qualifies to proceed with a Chapter 7 case under the means test. The means test is also used to determine whether the length of the debtor's Chapter 13 plan will be limited to three years (for debtors with less than the median income) or five years (for debtors exceeding the median income.)

Chapter 11

Chapter 11 governs business reorganizations and liquidations. Both individuals and entities may be debtors under Chapter 11. Generally, the debtor remains in control of its assets and manages its affairs, subject to court oversight, as a debtor-in-possession (or “DIP”) under sections 1107 and 1108. The DIP owes a fiduciary duty to creditors and the bankruptcy estate and exercises most powers of a Chapter 7 trustee. In situations involving fraud, dishonesty, or incompetence of the DIP, or when in the best interest of creditors, the bankruptcy court may appoint a trustee to take control of a Chapter 11 case under §1104.

The purpose of Chapter 11 is to allow the filing and confirmation of a plan of reorganization allowing the debtor to emerge from bankruptcy with restructured debt. For a Plan of Reorganization to be confirmed by the Court, it must generally be approved by the affirmative vote of the majority of each class of its creditors. This confirmed plan of reorganization operates as a contract between the debtor and all creditors and supersedes any prior agreements between the debtor and creditor. A plan often alters the debtor's repayment terms. In some cases, a Chapter 11 plan provides for the orderly liquidation of the DIP and its assets. In this situation, the DIP will remain in control of its assets and liquidate the estate for the benefit of creditors.

II. The Automatic Stay and its Impact on Collections Efforts.

A. The Automatic Stay in General

The Bankruptcy Code protects debtors from actions by their creditors by imposing an “automatic stay” against actions to collect their debts. This automatic stay is set forth in 11 U.S.C. § 362 and it generally goes into effect immediately upon filing. The purpose is "to facilitate the orderly administration of the debtor's estate." *Brock v. Rusco Industries, Inc.*, 842 F. 2d 270, 273 (11th Cir. 1988).

Specifically, the automatic “operates as a stay, applicable to all entities, of :

- (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; *such as the filing of or proceeding in a lawsuit against the debtor*
- (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; *i.e., the execution of a judgment against a debtor through garnishment, levy, or post-judgment discovery*
- (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; *i.e., foreclosure, repossession, eviction, or unlawful detainer actions*
- (4) any act to create, perfect, or enforce any lien against property of the estate; *i.e., the filing of a judgment or materialman’s lien or an attempt to execute on the same*
- (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; *i.e., all of the above, plus written demands, phone calls, etc...*
- (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. 11 U.S.C. § 362. *(comments added by author.)*

What is the “estate” that is created at the commencement of a bankruptcy case? It includes:

“all legal or equitable interests of the debtor in property as of the commencement of the case,... wherever located and by whomever held.” 11 U.S.C. § 541. Thus, when a debtor files a bankruptcy petition a creditor is barred by the automatic stay, without leave of court, from pursuing collection

of its debt or pursuing wrongs that arose prior to the filing of the bankruptcy petition against a debtor or any property of the debtor.

B. Co-Debtor filings.

Except for one significant exception, the automatic stay applies only to the filing debtor and its estate. The automatic stay does not protect that debtor's family or their individual property (as opposed to jointly-owned property.) Even though a debtor and their spouse are allowed to file a joint petition under § 302(a), the filing by one spouse independently does not stay action against the other spouse.

An individual debtor sometimes files a petition for itself and a closely held business as a joint case or lists the business entity as a d/b/a of the debtor. If the business listed is a separate legal entity, this is an invalid filing for the company. A separate case will technically be required in order to protect the assets of the entity. However, a cautious approach is to confirm the status of the entity and ownership of the assets, and potentially proceed after seeking authorization from the court through a stay relief or related motion.

The exception to this principal is provided by 11 U.S.C. §1301. That section creates a “co-debtor stay” that bars actions to collect **consumer** debts from non-debtor co-debtors in Chapter 13 cases. This provision provides in section (a) that:

Except as provided in subsections (b) and (c) of this section, after the order for relief under this chapter, a creditor may not act, or commence or continue any civil action, to collect all or any part of a *consumer* debt of the debtor from any *individual* that is liable on such debt with the debtor, or that secured such debt, unless--

(1) such *individual* became liable on or secured such debt in the ordinary course of such individual's business; or

(2) the case is closed, dismissed, or converted to a case under chapter 7 or 11 of this title.

Some relief is provided in certain situations, however, by paragraph (c):

On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided by subsection (a) of this section with respect to a creditor, to the extent that--

- (1) as between the debtor and the individual protected under subsection (a) of this section, such individual received the consideration for the claim held by such creditor;
- (2) the plan filed by the debtor proposes not to pay such claim; or
- (3) such creditor's interest would be irreparably harmed by continuation of such stay.

11 U.S.C.A. § 1301.

Keep in mind that this provision applies only to consumer debts, and protects only individual co-debtors rather than related entities. The stay applies only while the case remains open, and does not bar pursuit of co-debtors upon dismissal or discharge of the primary debtor. If one of the provisions of paragraph (c) applies, keep in mind that you must file a motion and obtain an order granting relief before you may proceed against the co-debtor.

C. Violation of the Automatic Stay

If the automatic stay provisions are violated, substantial penalties may be assessed against the offending creditor and possibly their attorney. A creditor must be aware of the concept of the automatic stay and immediately stop any and all foreclosure, repossession, or collection actions when it learns of the filing of a bankruptcy petition. Section 362(k) provides the following regarding violations of the stay:

- (1) Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.
- (2) If such violation is based on an action taken by an entity in the good faith belief that subsection (h) applies to the debtor, the recovery under paragraph (1) of this subsection against such entity shall be limited to actual damages.
(Paragraph (h) requires a debtor within as set period of time file a statement of

its intention to either retain or surrender all personal property collateral.)
(comments added by author.)

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