

Business Law

Text & Exercises *6th Ed.*

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Chapter 34: Bankruptcy

Learning Outcomes

- LO1** • Outline the debtor, procedures, and advantages of a Chapter 7 liquidation.
- LO2** • List the duties and powers of a bankruptcy trustee.

Learning Outcomes

- LO3** • Identify the debtor, procedures, and advantages of a Chapter 11 reorganization.
- LO4** • Summarize the debtor, procedures, and advantages of a Chapter 13 adjustment.

Introduction

- **Bankruptcy found under Article I, Section 8 of the U.S. Constitution.**
- **Bankruptcy Reform Act of 2005 significant modified bankruptcy laws.**
- **Federal Bankruptcy Courts under U.S. district courts, can appeal to district courts. Federally appointed judges.**

The Bankruptcy Code

- **Bankruptcy provides different relief:**
 - Chapter 7: Liquidation.
 - Chapter 11: Corporate Reorganizations.
 - Chapter 12: Family Farmers.
 - Chapter 13: Adjustment of Individuals' Debts with a payment plan.

Chapter 7 - Liquidation

- **Voluntary Bankruptcy:**
 - Any person (including corporation) can file.
 - All debts are liquidated (discharged).
 - Begins with a voluntary Filing of a Petition (Automatic Stay) by debtor.
 - If petition is proper, filing will sustain an **order for relief.**

Chapter 7 - Liquidation

- **Involuntary Bankruptcy**: debtor's creditors force debtor into bankruptcy proceedings. Can occur if:
 - Debtor has twelve or more creditors, three or more with claims totaling \$13,475, or
 - Debtor has twelve or more creditors, one has a claim totaling \$13,475.

Automatic Stay

- **Automatic Stay upon Filing either Voluntary or Involuntary Petition.**
 - Creditors cannot commence or continue most legal actions.
 - Damages for violation of stay.
 - Does not apply to paternity, alimony, spousal maintenance, child-support debts, and related proceedings.

Creditors' Meeting

- **Bankruptcy trustee must call meeting of creditors no later than 40 days after order of relief granted.**
- **Each creditor normally files a *proof of claim* within 90 days of meeting. A POC is necessary in case of disputes.**

Property of the Estate

- **Debtor's Estate includes:**
 - All Debtor's legal and equitable interests in property presently held, including community property,
 - Property transferred in a “voidable” transaction, and
 - Property which Debtor becomes entitled within 180 days after filing.

Property of the Estate

- **Estate includes (*cont'd*):**
 - Proceeds and profits from the property of the estate.
 - After-acquired property such as inheritances, property settlements, and life insurance death proceeds.

Exemptions

- Up to \$20,200 in home equity.
- Up to \$3,225 in car.
- Up to \$10,775 in personal possessions (up to \$525 per item).
- Up to \$1,350 in jewelry.
- Up to \$2,025 in tools.
- Social security, alimony and support payments.
- Up to \$20,200 in personal injury awards.
- **2005 Act: Homestead Exemption.** (Debtor must have lived in state two years. Up to \$136,875 of equity.)

Trustee's Powers

- **Court-appointed until first meeting of creditors.**
- **Creditors elect permanent trustee**
- **Administers estate.**
- **Collects proceeds, liquidates assets and pay Creditors in order of priority.**

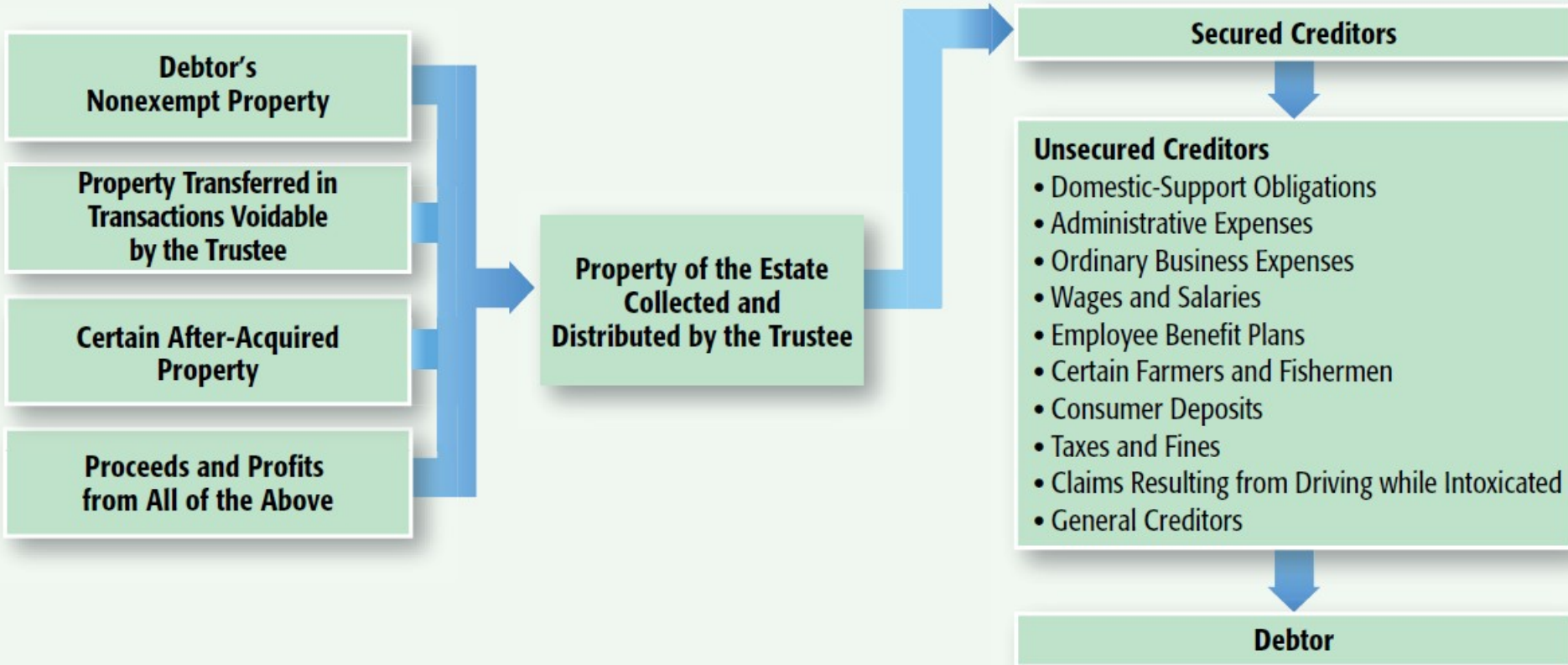
Trustee's Powers

- **Right to Possession of Debtor's Property:** constructive possession (e.g., change lock on door).
- **Avoidance Powers:** Trustee can set aside a sale or transfer of debtor's property (2005 Act: cannot avoid *bona fide* domestic support debt).

Trustee's Powers

- **Preferences.**
 - Debtor is not permitted to transfer property or make a payment that favors—or gives a preference to—one creditor over another.
- **Fraudulent Transfers.**
 - Trustee may avoid fraudulent transfers or obligations if made within two years of filing, OR if made with intent to defraud a creditor.

Property Distribution



Distribution of Property: Secured

- **If Secured Creditors:**
 - If value of the secured collateral exceeds the secured party's claim, the secured party has priority to proceeds.
 - If debtor surrenders, creditor can keep or sell.
 - If creditor keeps = full satisfaction of debt.
 - If creditor sells = can use extra for costs, or can become unsecured creditor for deficiency.

Distribution of Property: Unsecured

- **Unsecured Creditors:**
 - Paid according to bankruptcy law.
 - All of one class must be paid before moving to next.
 - Creditor within last class receive proportionately if not enough.
 - See Priority List in text.
 - All creditors paid, trustee gives extra back to debtor.

Chapter 7—Discharge

- **Exceptions.→**
- **Objections to Discharge. →**
- **Effect of Discharge.**
- **Revocation of Discharge.**
- **Reaffirmation of a Debt.**

Chapter 7—Exceptions to Discharge

- **Claims for back taxes.**
- **Claims for amounts borrowed by Debtor to pay federal taxes.**
- **Claims against property/money obtained by Debtor under false pretenses.**
- **Claims by Creditors who did not know about bankruptcy.**
- **Student Loans.**

Objections to Discharge

- **Bankruptcy court may deny the discharge of the debtor (not the debt):**
 - If intentional concealment or destruction of property or financial records.
 - Discharge within 8 years of previous bankruptcy.
 - Failure to complete credit counseling courses, or debtor found guilty of felony.
- **Discharge may be revoked within 1 year.**

Chapter 11-Reorganizations

- **Debtor and Creditors formulate a plan under which the Debtor pays a portion of its debts and is discharged of the rest.**
- **Any debtor eligible for Chapter 7 is also eligible for Chapter 11. Same principles of voluntary vs. involuntary apply.**

Chapter 11-Reorganizations

- **Creditors' Committees.**
 - Unsecured creditors appointed to consult with trustee.
 - In small business bankruptcies (less than \$2.19 million in debt with no real estate) do NOT require consent of committee.

The Chapter 11 Plan

- **The Chapter 11 Plan:** conserve and administer the debtor's assets with the goal of returning to successful operation and solvency.
- **The plan must:**
 - 1. Designate classes of creditors under the plan.
 - 2. Specify the treatment to be afforded the classes of creditors and provide the same treatment for each claim.
 - 3. Provide an adequate means for the plan's execution.

The Chapter 11 Plan

- **Filing the Plan.**
- **Confirming the Plan.**
 - Confirmation does not discharge a debtor.)
 - Class of creditors accepts plan when creditors representing 2/3 value of total claim.
 - Court may “cram down” plan on all creditors if it is fair and equitable.

- For individuals (not partnerships or corporations) with regular income who owe fixed unsecured debts of **<\$336,900** or fixed secured debts of **<\$1,010,650**.
- **Filing the Petition:** can only be initiated by voluntary petition by debtor OR conversion from Chapter 7. Upon filing of plan petition, automatic stay is granted.

The Chapter 13 Plan

- **Only debtor may file a plan which may provide for repayment of up to 100% of all obligations. The plan must provide for:**
 - Turnover of earnings to trustee to execute plan.
 - Full payment of all priority claims (such as taxes).
 - Repayment (3-5 years) depending on family income.
 - Same treatment of each claim with class.

The Chapter 13 Plan

- **Confirmation of the Plan.** Court will confirm a plan when:
 - Secured creditors have accepted the plan, OR
 - Plan provides secured creditors can retain their liens until full payment or discharge, OR
 - Debtor surrenders collateral to the creditors.
 - **PMSI**: creditor retains lien on a motor vehicle purchased within 910 days of filing petition.

The Chapter 13 Plan

- **Objecting to the Plan.** Unsecured creditors cannot object. Court can approve a plan over the objection of the trustee or any unsecured creditor in either of the following situations:
 - 1. The value of the property to be distributed under the plan equal to the amount of the claims.
 - 2. All of the debtor's projected disposable income to be received during the plan period will be applied to making payments.

Chapter 13—Discharge

- **After completion of all payments, the bankruptcy court grants discharge of all remaining debts provided in the plan.**
- **NON-Dischargeable Debts:** fraud, domestic support, student loans, damages from driving under influence, unless debtor can show “undue hardship.”