Overview of Bankruptcy, the Automatic Stay, and the Discharge Injunction

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Overview of Bankruptcy

- There are two basic types of bankruptcy, Chapter 7 and Chapter 13, that you will need a general understanding of. These are the most common types of bankruptcy.

- There are four other types of bankruptcy: Chapter 9, Chapter 11, Chapter 12, and Chapter 15. These are rare but can be very complicated and you should consult an attorney if you receive notice of one.

- Bankruptcy can be filed by individuals and by most companies. Individuals can file Chapter 7, 11, 12, or 13. Companies can file Chapter 7, 11, or 12.

- Debtors filing bankruptcy must file "schedules" that disclose what assets they have and the value of their assets, their creditors and the amount of their debts, any leases they are in, their income and expenses, and information about the debtor's recent financial transactions. The debtor is also required to notify creditors of the bankruptcy case.

- When a debtor files bankruptcy, a "bankruptcy estate" is formed. Property in the bankruptcy estate will be sold and the proceeds will be distributed to unsecured creditors.

- A bankruptcy trustee is appointed to represent unsecured creditors, ensure the debtor's and creditors' compliance with the bankruptcy rules, and potentially seize assets as part of the bankruptcy estate.

- Not all claims are treated equally. Some claims are secured by property, and the holders of secured claims are entitled to look toward their collateral (subject to the automatic stay). Other claims are entitled to "priority," meaning they get paid before the remaining unsecured creditors get paid.

- All bankruptcy debtors must attend and testify at a meeting of creditors, where the trustee will ask them questions about their assets. Creditors are allowed to attend and ask the debtor questions.

- It is possible to file one type of bankruptcy case and "convert" it to another type of bankruptcy case. For example, sometimes debtors who file Chapter 13 bankruptcy will convert the case to Chapter 7.

- Individuals who successfully complete bankruptcy will typically receive a "discharge" of most of their debts, meaning they will no longer be personally liable for such debts.

- All bankruptcy cases can be accessed via "PACER," which is the nationwide case locator of all federal cases. The website is www.pacer.gov. A membership is required to use PACER, and users are billed quarterly based on usage.

- Companies can file claims in bankruptcy cases on their own behalf, but cannot otherwise appear in bankruptcy court on their own behalf. They must hire an attorney to represent them in bankruptcy court if they need to do anything besides filing a claim.

Chapter 7 Bankruptcy – Liquidation

- Chapter 7 bankruptcy, or liquidation, is the simplest form of bankruptcy. It means that the debtor cannot afford to pay anything towards creditors, and is willing to allow his, her, or its non-exempt property to be seized by the trustee and sold to pay creditors.

- Chapter 7 bankruptcy typically lasts 5 or 6 months.

- A Chapter 7 bankruptcy estate consists of all assets the debtor has or is entitled to at the moment he, she, or it files bankruptcy. With a few exceptions, any property acquired by the debtor after filing bankruptcy does not become property of the bankruptcy estate.

- If the debtor has no assets the trustee will issue a report of "no distribution," in which case unsecured creditors will not get paid from the bankruptcy estate because the estate has nothing in it. This is the result of most Chapter 7 bankruptcy cases.

- If the debtor has assets, the trustee will send creditors a notice to file claims stating how much they owe and whether they are secured or entitled to priority distribution. A creditor must file a claim to get paid from the bankruptcy estate.

- A company cannot get a Chapter 7 discharge – instead, it is simply dissolved. Individuals can discharge most types of debts in Chapter 7.

Chapter 13 Bankruptcy – Individual Debt Consolidation

- Chapter 13 bankruptcy is similar to debt consolidation. A debtor may keep his or her property in Chapter 13 but must propose a payment plan to address his or her debts. If the bankruptcy court approves the plan (known as "confirmation"), the debtor will make payments to the trustee and the trustee will disburse the proceeds to creditors according to the terms of the plan.

- Creditors may file claims in the bankruptcy court but are not obligated to. However, they cannot be paid by the trustee from the bankruptcy estate unless they file a claim.

- Debtors who file Chapter 13 bankruptcy must comply with several requirements before the bankruptcy court will approve their plan. Most importantly, the debtor must pay at least as much to unsecured creditors as they would receive if the case were a Chapter 7 case, and the debtor must either fully pay creditors or commit their disposable income toward plan payments for 3 to 5 years.

- Property of a Chapter 13 bankruptcy estate includes not only the debtor's assets at the moment bankruptcy is filed, but also the debtor's earnings and income during the pendency of the bankruptcy case.

- Most successful Chapter 13 bankruptcy cases last 5 years. However, many debtors do not complete Chapter 13 bankruptcy and get their cases dismissed by the bankruptcy court. If a debtor's case is dismissed, the debtor cannot get a discharge for that case. However, a debtor can file a new bankruptcy case and try again.

- When the bankruptcy court confirms a Chapter 13 plan, the debtor and all creditors are bound by the terms of the plan, whether they favored the plan or not.

- If a debtor successfully complies with the terms of his or her confirmed Chapter 13 plan, he or she will discharge most of their debts.

The Automatic Stay

- Whenever a new bankruptcy case is filed, all collection activity against the debtor and his, her, or its property is automatically stayed (in other words stopped or prohibited) pursuant to 11 U.S.C. § 362. This is known as the "automatic stay."

- The automatic stay begins the moment the bankruptcy petition is filed and continues until the end of the bankruptcy case (either dismissal or discharge of the debtor).

- Creditors may ask the bankruptcy court for permission to initiate or continue collection action, known as seeking "relief from the automatic stay." Permission is typically granted when a secured creditor is seeking to recover its collateral or when the debtor has been involved in a traffic accident and the plaintiff wishes to sue the debtor's insurer. Unsecured creditors typically cannot obtain relief from the automatic stay.

- Activity prohibited by the automatic stay includes filing or maintaining lawsuits, calling the debtor to ask for debt payment, sending the debtor collection letters, seizing the debtor's property, threatening the debtor, withholding something the debtor is entitled to as a way to coerce payment, or setting off a debt owed to the debtor based on a debt owed by the debtor. Broadly, the automatic stay prohibits "any act to collect" a debt existing prior to the bankruptcy filing.

- Anyone who violates the automatic stay of a pending bankruptcy case can be sued and held liable for actual damages, including the plaintiff's attorneys' fees, and for punitive damages. These can get up to the tens of thousands of dollars. Even if the defendant of a lawsuit for violating the automatic stay ultimately prevails in the lawsuit, it will likely have to spend substantial sums in attorneys' fees and litigation costs.

The Discharge Injunction

- The automatic stay ends once the bankruptcy case ends. However, if the debtor gets a bankruptcy discharge, then a "discharge injunction" is put into effect. The discharge injunction prohibits any attempt to collect or coerce payment of a discharged debt.

- A debtor may voluntarily repay a discharged debt, but the creditor cannot do anything to obligate repayment.

- A creditor may refuse to issue new credit to a debtor who has received a bankruptcy discharge. If the creditor agrees to extend new credit, it cannot require repayment of the discharged debt as a condition of extending new credit or entering a new agreement.

- Debtors who file bankruptcy can agree with a creditor to remain personally liable on the debt owed to the creditor. This is known as a "reaffirmation agreement." Reaffirmation agreements must be approved by the bankruptcy court during the bankruptcy case and are carefully reviewed. The debtor has the power to rescind (get out of) a reaffirmation agreement for a short time after entering it.

- Anyone who violates a discharge injunction can be sued, held in contempt of the bankruptcy court, and forced to pay damages, including the debtor's attorney's fees.