

Who is eligible to file a Chapter 7 bankruptcy?

Almost any person or business organization is eligible for Chapter 7 relief: it is available to individuals, partnerships, corporations, limited liability companies and limited liability partnerships. There is no requirement that you have any certain amount of debt, or that your expenses exceed your income.

Your property becomes “the estate”

When you file bankruptcy, a bankruptcy **estate** is automatically created. The term estate means that a legal entity separate from you has come into existence. The estate legally owns everything you owned on the date you filed bankruptcy, as well as any inheritance or divorce settlement you receive or become entitled to receive within 180 days of the date you filed bankruptcy.

Although the estate owns everything, it does not take possession of them. You continue to possess and use them, and generally will not lose anything to the estate. That is because you are entitled to exemptions, and because some of your creditors have claims on your assets that are superior to the claims of the estate. If you own a home, but have a mortgage on it, or if you own a car you are buying on credit, those lenders have a claim against the house or the car: these claims are called **security interests** and the lenders are called **secured creditors**.

Exempting personal property from liquidation

You have the right to claim some things, like household furnishings, insurance policies, and homestead equity, free of the claims of your creditors. The items which you can keep for yourself in this way are called **exempt assets**, because they are exempted from the things which could be taken to pay debts.

The usual result in a Chapter 7 bankruptcy is that your exemptions and the claims of your secured creditors use up the value of all your assets, and so there is nothing for the trustee to get. The bankruptcy estate abandons any claim to your assets and you keep them. However, your right to keep the assets is subject to the rights of your secured creditors. They have the right to be paid the value of the assets they have claims against.

Although the things you own temporarily belong to the estate, the **money you earn** after filing does not go into the estate. Your right to have post-bankruptcy earnings free from creditors' claims is usually the main benefit of filing bankruptcy.

The Trustee of the case

The estate is run by a federally-appointed lawyer who is called a **trustee**.” The trustee’s main job is to try to find money for the creditors whose **claims** are **not secured** by an asset like a house or a car. These other creditors are called **unsecured creditors**. The trustee can get money for them if you have assets which are not exempt, and which are not mortgaged for more than they are worth. If the trustee finds assets to sell for the benefit of unsecured creditors, the trustee will examine all creditors’ claims, and object to any improper claims.

NOTE: The trustee very seldom is able to get any money for unsecured creditors. The trustee may also investigate the financial affairs of the debtor and object to discharge if you have committed fraudulent acts.

Benefits of filing for Chapter 7 bankruptcy relief

The object of a Chapter 7 bankruptcy is to obtain a court order **eliminating the debts** which existed on the date the bankruptcy court received the petition in bankruptcy. This order is called the **Order of Discharge**, or simply, the discharge.

Another major benefit of a bankruptcy petition is **freedom from telephone collection calls** and lawsuits. When a bankruptcy petition is filed, the court orders all such activities stopped; an **automatic stay** automatically goes into effect. The stay brings all claims against you and your assets before one court, and gives you a break from collection activity.

If a creditor violates the stay, that violation is an act in contempt of the Bankruptcy Court’s order. The court may award you actual damages, including costs and attorneys’ fees, and in appropriate circumstances, punitive damages.

If a secured creditor requests relief from the stay, and proves that their interests (in your house or car, for example) are not adequately protected, or that you have no equity in the property and that the property is not necessary to an effective reorganization, the Bankruptcy Court can grant relief from the automatic stay, which would then allow the creditor to repossess its collateral.

Most of the time, this is avoided by making an agreement with the creditor to treat the debt as though the bankruptcy had never occurred. Such arrangements are called **reaffirmation agreements**.

The **relative benefits** of Chapter 7 with respect to other bankruptcy options must also be considered. Chapter 7 is the quickest, shortest, cheapest remedy: Chapter 13 discharges more debts than does Chapter 7; and Chapter 11 may be only remedy available if Chapter 7 will not meet the reorganization needs of debtor, and debtor is ineligible for 12 or 13.

The automatic stay ends when the case ends, but that does not eliminate your protection from creditors; the court enters an order of discharge at the end of the case, which enjoins any act to collect, recover, or offset any discharged debt.

The ordinary course of events in a Chapter 7 proceeding

1. **A Chapter 7 begins when you consult an attorney** and the two of you consider your goals and the available means of achieving those goals. Common goals are to escape collection calls and lawsuits, eliminate debt so far as possible, continue ownership and possession of home and car, and sometimes, to preserve a business. You and your attorney should consider **alternative ways** to achieve your goals, such as settlements with the problem creditors, deferment of payments, surrender of assets, and requesting an informal forgiveness of debt. Sometimes creditors will have violated your rights, so that claims can be brought against the creditor under the Federal Fair Debt Collection Practices Act, or laws like the Wisconsin Consumer Act.
2. When the Chapter 7 option is selected, you **complete a questionnaire** which provides most of the information needed to file your case. When the information is all gathered, your attorney will analyze which exemptions will best protect your assets, state or federal. He will counsel you on converting non-exempt assets to exempt assets wherever possible. After your assets have been protected as far as possible, the bankruptcy petition and schedules are prepared for filing with the court.
3. When your schedules are ready, **your attorney will review them with you**, revise them as needed, **and have you sign them**. Then they are **filed with the bankruptcy court**.
4. When the Bankruptcy Court receives the papers, it enters the Order for Relief. The automatic stay is imposed, the trustee is appointed, the First Meeting of Creditors is scheduled (usually about 1 month after filing), and the last day to Object to Discharge is established. The week after it gets the bankruptcy petition, the court mails the notice of the meeting to everyone listed on the mailing matrix. The court sends a complete copy of the filed documents to the Trustee.
5. At the **First Meeting of Creditors**, the trustee presides; the bankruptcy judge is prohibited from attending by law. At the meeting the Trustee swears you in and questions you about your financial affairs. The Trustee will question any transfers of property to friends or relatives in the preceding 12 months, and transfers to any creditors in the preceding 90 days. The Trustee is empowered to reverse any such transaction that is improper. Creditors may also question you, but do not usually do that. After the First Meeting the trustee will sell any available assets for the benefit of creditors who hold unsecured claims. The trustee will also attempt to recover certain payments from creditors you have paid, and will attack any questionable exemption claim made in your case. In rare cases, the Trustee might object to your discharge if any legal basis for objection appears.
6. About two to three months after the Meeting of Creditors, the bankruptcy court will issue the order to discharge your debts and will close your case. A bankruptcy proceeding does not discharge every debt. **Some debts are automatically not dischargeable**, including certain income taxes, un-filed taxes, student loans, some restitution orders, child support, and damages for death or personal injury caused by intoxicated operation of a motor vehicle. Other debts may be excluded from the discharge by bankruptcy court order, such as debts incurred under false pretenses or by fraudulent financial statements, or certain divorce property divisions.

REORGANIZATION UNDER THE BANKRUPTCY CODE – Chapter 13

The purpose of Chapter 13 cases is the rehabilitation of wage-earners who can pay back all or a portion of their debt if given time and protection from their creditors. It is not available to partnerships, corporations, or other business organizations: only individuals and couples may file Chapter 13. In these cases, you make payments to creditors out of your earnings or other income for three to five years after filing bankruptcy, and creditors receive more money than they would get if you filed under Chapter 7. The filing fee is \$185.00.

People with large debts cannot file Chapter 13. The debt limit (as of April 1, 2002) for unsecured debt is \$290,525. Secured debt cannot exceed \$871,550. There are significant differences between Chapter 7 and Chapter 13. For example, Chapter 7 frees future income in exchange for possible (but not likely) liquidation of present assets: in Chapter 13 you give up future income for greater power to retain present assets and to get a broader discharge.

Chapter 13 offers a broader discharge than is available in other bankruptcy chapters. This benefit is given only if you complete your plan: if the plan is not completed, only the Chapter 7 discharge is given.

If the plan is completed, additional debts are discharged, including debts declared non-dischargeable in prior bankruptcy proceedings, restitution ordered in federal cases, debts for wilful and malicious injury to another or to the property of another, debts incurred under false pretenses or by fraudulent financial statements, debts incurred by fraud while acting as a fiduciary, embezzlement, or larceny, and divorce property divisions. Tax claims that are non-dischargeable in Chapter 7 are effectively non-dischargeable in Chapter 13 because a Chapter 13 plan cannot be confirmed unless the plan provides for full payment of such claims.

Chapter 13 plans cannot be confirmed unless distributions under the plan to unsecured creditors equal the amount they would have received in a Chapter 7 liquidation of the debtor. Unsecured creditors do not get whatever trustee collects: they get the net, the gross reduced by the trustee's costs of collection and any taxes the trustee owe. This serves to reduce the required payout for confirmation of a Chapter 13 plan.

Rights of creditors who hold liens only on the debtor's homestead may not be modified, except to cure a default on the debt. Such loans may only be reinstated through a Chapter 13 plan. The Plan often serves to bring homestead debt current and keep a mortgage foreclosure from occurring. The primary use of Chapter 13 is the rehabilitation of small businesses, farms and wage-earners; it saves a house or a car that is being lost due to short-term financial reverses.

The usual attorneys' fees for a Chapter 13 are \$1,000 for smaller cases. Fees range up to \$5,000 for a business reorganization. These fees can be paid through the plan, rather than being paid in advance, which helps many debtors.

In a Chapter 13, the debtor files all of the paperwork required for Chapter 7, plus a plan detailing the proposed treatment of taxes and secured claims and the amount debtor proposes to pay toward unsecured claims. The plan must be filed within 15 days of the filing of the petition, and payments must begin within 30 days of the filing of the petition.

The case is automatically assigned to a "standing trustee" who performs the functions of a Chapter 7 trustee, and serves as receiving and disbursing agent for plan payments. The trustee retains 10% of every payment that passes through his hands.

After the first meeting of creditors, the trustee recommends confirmation or denial of confirmation of the plan based on feasibility, compliance with the chapter 7 "hypothetical dividend" test, compliance with the Chapter 13 disposable income test, and the good faith of the debtor in proposing the plan. Creditors may object to confirmation of the plan for failure to comply with the standards for confirmation, also.

If the plan is confirmed, but circumstances change, the court can modify the plan to take account of the new developments in the case.

Reorganization under Chapter 11

Chapter 11 is the reorganization vehicle for larger businesses and for any size corporation, since corporations are ineligible for Chapter 13 relief. Its purpose is to rehabilitate commercial, retail and mercantile businesses. This serves the public interest by preserving jobs of employees and preserving going-concern value for creditors.

The provisions of Chapters 11 & 12 also provide a standard against which participants in out of court restructuring negotiations can measure the product of their discussions, and evaluate the wisdom of settlement. Business bankruptcies, of which Chapter 11 filings are a large part, are only 4% of total filings annually.

Any entity which could file a Chapter 7 may file a Chapter 11, except for railroads, commodity brokers and stockbrokers. No debt limits apply.

Chapter 11 differs from Chapter 7 in important ways:

- The debtor is generally trying to preserve more of its business relationships with creditors, especially suppliers.
- In the absence of debtor fraud, the case will proceed without appointment of a trustee: the debtor will perform trustee functions as a quasi-fiduciary, under the supervision of the US Trustee's office and often with the supervision and assistance of a creditors' committee appointed by the US Trustee.
- The debtor will propose whether to liquidate all or any part of its business as part of the rehabilitation, rather than having trustee make that decision.
- A corporation can receive a discharge in Chapter 11, if it continues in business after the plan is consummated.

Chapter 11 is also different from Chapter 13:

1. Debts are usually far larger, and businesses more complex.
2. A Chapter 11 is almost never a wage-earner case.
3. The debtor has far less power to coerce creditors in Chapter 11:
 - a. Creditors vote on confirmation.
 - b. Secured creditors can elect to be treated as fully secured, compelling debtor to either pay in full, sell the collateral and turn the proceeds over to the creditor, or surrender the collateral.
4. No broad discharge is granted: the discharge is identical to Chapter 7, except that a corporation can receive a discharge if it continues in business after consummation of the plan.
5. There is no limit on plan duration.

Chapter 11 Procedure

The schedules and other filings are like a Chapter 7 filing. The employment of debtors' counsel and any other professionals debtor may need for reorganization requires court approval; the standard is whether such services are in the best interest of the estate, and whether the professional is disinterested, holding no interest adverse to the estate. All payment of debtors' professionals requires court approval.

A first meeting of creditors like the Chapter 7 meeting is held; an Assistant US Trustee presides. The debtor has the exclusive right to file a plan of reorganization for the first 120 days after the petition is filed, or 100 days if a small business election is made.

The court may shorten or lengthen the exclusive plan-filing period. After exclusivity ends, anyone may file a plan. During the pendency of the case, secured creditors seek protection from loss in value of their collateral; protection is usually in the form of casualty insurance plus payments to cover any loss by depreciation. If protection is not provided, secured creditors are entitled to relief from stay and abandonment.

If the secured creditor's collateral is cash or accounts receivable, the creditor receives special protection from use of the collateral without replacement of the fund or the account receivable.

When a plan of reorganization has been formulated, the proponent of the plan files a disclosure statement which is like an SEC prospectus, intended to inform creditors of the contents of the plan. The document may not be circulated without court approval. Once the disclosure statement is approved, all parties may seek votes for or against plan.

The Plan must divide creditors into classes: each class must include claims which are substantially similar. In the case of secured claims, the class must be similar as to security interests held and priority. A class accepts the plan if it receives the favorable vote of:

- 1) more than $\frac{1}{2}$ of the total number of eligible votes cast in the class; and
- 2) at least $\frac{2}{3}$ in dollar value of the claims of eligible votes cast in the class.

The Plan will be confirmed if the judge is persuaded that the Plan is proposed in good faith, that all administrative expenses and post-petition taxes are paid in full or claim-holder consents to other treatment, and that all impaired classes have accepted the plan, or receive an amount equal to the hypothetical Chapter 7 dividend. Alternatively, the court may find that the plan does not discriminate unfairly, and is fair and equitable with respect to the rejecting class.

The plan must provide that non-dischargeable taxes are paid within 6 years of assessment.

The fundamental concept of Chapter 11 reorganization is that debtor and creditors must work out a plan that is essentially consensual, except that a small group of oppositional creditors will not be allowed to prevent reorganization. Chapter 11 often serves to preserve the position of incumbent management while replacing the former stockholders with the former unsecured creditors.

Attorneys fees are seldom less than \$10,000, often are \$25,000 to \$50,000 in a smallish case, and can be astronomical. Accountants' fees are generally in the same range.

The Chapter 11 filing fee is \$830. In addition, the debtor must pay the U.S. Trustee's quarterly fees:

1. If disbursements <\$15,000: \$250
2. If disbursements >\$15,000-\$75,000: \$500
3. If disbursements \$75,000-\$150,000: \$750
4. The sliding scale continues up to cases disbursing more than \$5,000,000 per quarter, which pay in \$10,000.

Reorganization under Chapter 12

Chapter 12 was enacted in 1986 to provide farmers with a bankruptcy procedure under which the low debt limits of Chapter 13 would not apply, and the inherent barriers of Chapter 11 would not preclude reorganization. The Chapter 11 obstacles included cost, the secured creditors' effective veto power, and the absolute priority rule, which precludes a Chapter 11 reorganization if unsecured creditors reject the plan and debtor proposes to remain in control of the assets of the business.

Chapter 12's historical antecedent is the Frazier-Lemke act of 1934, which allowed farmers to retain farm assets for five years in exchange for payment of a reasonable rental fee for the assets and allowed farmers to purchase their assets free from the claims of creditors by paying the appraised value of the assets during the five year period. The U.S. Supreme Court declared Frazier-Lemke unconstitutional in 1935, Congress fixed it that year, and the Supreme Court upheld the Act in 1937. Frazier-Lemke expired when Senator Lemke died in 1949.

Confirmation and consummation rates in Chapter 12 appear to be higher than Chapter 11 rates. Approximately 60% of filings result in confirmed plans, and 90% of confirmed plans are not merely consummated, but are completed.

Like Chapter 13, Chapter 12 has eligibility standards. The debtor must have aggregate debts \$1,500,000 or less, which are: owed by an individual (or husband and wife): 80% of the debt is farm-related: and 50 % of the gross income for prior tax year was farm-related.

Corporations and partnerships are eligible if they are 50% owned by one family, or one family and its relatives: 80% of the entity's assets are related to farm operation: 80% of the debt is farm-related, and the stock is not publicly traded.

In any case, income must be sufficiently stable and regular to permit plan payments to be made.

Chapter 12 procedure

The debtor files all of the paperwork required for Chapter 7, plus a plan detailing the proposed treatment of taxes and secured claims and the amount debtor proposes to pay on unsecured claims. The Chapter 12 filing fee is \$230.00. No disclosure statement is required, but the plan must be filed within 90 days of petition filing. Confirmation hearings must be completed within 45 days of plan filing.

As in Chapter 13, the case is automatically assigned to a "standing trustee:" who serves as receiving and disbursing agent for plan payments, retains 10% of every payment that passes through his hands, and recommends confirmation or denial of confirmation of plan based on the standards described for Chapter 13.

As in Chapter 13, the court retains the power to modify the plan after confirmation.

Conclusion

With these avenues of relief, Chapters 7, 11, 12, and 13, Congress has provided distressed individuals, businesses and their creditors a comprehensive set of rules and methods for dealing with the problems which inevitably arise when an enterprise fails. Although problems do exist, these chapters comprise the most successful system ever devised for managing these matters. With the assistance of competent counsel, debtors and creditors alike can participate in these proceedings secure in the knowledge that their legitimate rights and interests will be protected.

Business and Farm Property.

815.18(3)(b)

including: Equip., inventory, farm products & professional books used in the business of debtor or business of a dependent of debtor, not to exceed \$7,500 in aggregate value.

Child support, family support, maintenance payments.

815.18(3)(c)

Alimony, child support, family support, maintenance or separate maintenance payments to the extent reasonably necessary for the support of debtor & debtor's dependents.

Consumer goods.

815.18(3)(d)

Household goods & furnishings, wearing apparel, keepsakes, **jewelry & other articles of personal adornment**, appliances, books, musical instruments, firearms, sporting goods, animals or other tangible personal prop. held primarily for personal, family or household use of debtor or dependent of debtor, not to exceed \$5000 in aggregate value.

Life Insurance.

815.18(3)(f)

Any unmaturred life insurance contract owned by debtor & insuring debtor & insuring debtor's dependent or an individual of whom debtor is a dependent, other than a credit life insurance contract, & debtor's aggregate interest, not to exceed \$4,000 in cash value.

Motor Vehicles.

815.18(3)(g)

Motor vehicles not to exceed \$1200 in aggregate value. Any unused amount of the aggregate value from par. (d) may be added to this exemption to increase the aggregate exempt value of motor vehicles under this paragraph.

Retirement Benefits (abridged).

815.18(3)(j)

Assets held or amounts payable under any retirement, pension, disability ...plan, annuity, individual retirement account, individual retirement annuity, Keogh, 401-K or similar plan ... The benefits of this exemption with respect to an owner-dominated plan ... shall be limited to the extent reasonably necessary for the support of the debtor & the debtor's dependents.

Depository Accounts.

815.18(3)(k)

Depository accounts in aggregate value of \$1,000.

Real Estate.

\$40,000.00 equity in homestead real estate.

Personal Injury Claims

The debtor's right to receive up to \$25,000 on account of personal bodily injury, including pain and suffering or compensation for actual pecuniary loss...

FEDERAL EXEMPTIONS

CODE

Business and farm property.

11 USC §522(d)(6)

The debtor's aggregate interest, not to exceed \$1,750 individual or \$3,500 joint, in value in any implements, professional books, or tools of the trade of debtor or trade of a dependent of debtor.

Child support, family support, maintenance payments.

11 USC §522(d)(10)(D)

Alimony support or separate maintenance, to the extent reasonably necessary for the support of debtor and any dependent of debtor;

Consumer goods.

11 USC §522(d)(3)&(4)

Debtor's aggregate interest, not to exceed \$450 in value in any particular item or \$9,300 individual or \$18,600 joint, in aggregate value, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, and

Jewelry: aggregate interest, not to exceed \$1,150 individual or \$2,300 joint, in value, in jewelry held primarily for the use of debtor or dependents of debtor;

Life Insurance.

11 USC §522(d)(7)

Any unmaturing life insurance contract owned by the debtor, other than a credit life insurance contract.

Property of an Estate.

11 USC §522(d)(8)

Debtor's aggregate interest, not to exceed in value \$8,725 individual or \$17,250 joint, less any amount of property of the estate transferred in the manner specified in Sec. 542(d) of this title, in any accrued dividend or interest under, or loan value of, any unmaturing life insurance contract owed by debtor under which insured is the debtor or an individual of whom the debtor is a dependent.

Motor Vehicles.

11 USC §522(d)(2)

Debtor's interest, not to exceed \$2,775 individual or \$5,550 joint, in value, in one motor vehicle.

Retirement Benefits.

11 USC §522(d)(10)

The debtor's right to receive--

(A) a social security benefit, unemployment compensation, or a local public assistance benefit; (B) a veteran's benefit; (C) a disability, illness or unemployment benefit; (E) a payment under a stock bonus, pension, profit-sharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary...

Catch-all exemption.

11 USC §522(d)(5)

The debtor's aggregate interest in any property, not to exceed in value \$925 plus up to \$8,750 individual or \$16,150 joint of any unused amount of the exemption provided under 11 USC §522(d)(1).

Real Estate.

11 USC §522(d)(1)

Debtor's aggregate interest, not to exceed \$17,425 individual or \$34,850 joint in value in real or personal property that debtor or dependent of debtor uses as residence, in a cooperative that owns property that debtor or dependent uses as residence, or in a burial plot for debtor or dependent of debtor.

Personal Injury Claims

11 USC 522(d)(11)(D)

The debtor's right to receive up to \$17,425 individual or \$34,850 joint on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss...