

**EVERYTHING YOU ALWAYS WANTED TO KNOW ABOUT BANKRUPTCY,
BUT WERE AFRAID TO ASK**

Part I: What is Bankruptcy?

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In 2012, there were 1,221,091 Bankruptcy filings in the United States¹. We hear the word *BANKRUPTCY* on a daily basis in the news, but what is it? This article will briefly explore the history of bankruptcy, the different types of consumer bankruptcy and the basic bankruptcy process.

HISTORY

In Ancient Greece, a Debtor who was unable to pay his Creditor, along with his wife and children, was enslaved by his Creditor for a period of up to five years, enabling the Creditor to recoup his losses via physical labor. Any servants of the Grecian Debtor were also forced to serve the Creditor and could be retained for the remainder of their lifetime by the Creditor.

An early form of Bankruptcy also existed in Ancient Rome. In contrast to Ancient Greece, a Debtor in Ancient Rome could voluntarily turn over assets to Creditors of his estate for payment of his debts, or a Creditor could obtain a judgment against the Debtor and sell his assets involuntarily, with the proceeds going to the Creditor to satisfy the judgment.

Modern European civilizations began developing and adopting statutes dealing with insolvency and collection of debts in the middle ages². It is reported that under the reign of King

¹ www.uscourts.gov/statistics/BankruptcyStatistics.aspx

² Britannica Online Encyclopedia, <http://www.britannica.com/EBchecked/topic/52019/bankruptcy>

Philip II, Spain became not only the first sovereign nation to declare bankruptcy, but it did so four times (1557, 1560, 1575, and 1596).

In 1789, the United States Constitution gave power to Congress to legislate regarding Bankruptcy. The Nelson Act of 1898 was the first Bankruptcy Act in the United States, establishing the modern concepts of Bankruptcy Law. The Chandler Act followed in 1938 and was replaced by the current United States Bankruptcy Code, which has been amended numerous times since its inception in 1978. The most recent amendment was the Bankruptcy Abuse and Consumer Protection Act of 2005 (also known as BAPCPA).

In general, a Debtor is “bankrupt” when he/she lacks the resources to pay his/her debts as they become due. A Debtor need not be totally impoverished in order to be adjudged “bankrupt.” Federal and State laws allow a Debtor to protect certain assets that are exempt from collection by his/her Creditors.

TYPES OF BANKRUPTCY

There are four types of Bankruptcy, each referred to as a Chapter. In order to file Bankruptcy under one of these Chapters, a Debtor must meet the basic requirements for that Chapter. The four Chapters are:

Chapter 7: Chapter 7 is commonly known as a “liquidation.” In this type of Bankruptcy, a local Chapter 7 Trustee is appointed, in a blind draw, by the United States Trustee’s office to each case filed in the United States and its territories. The Trustee acts as the information gatherer for the United States Trustee. The Trustee determines if there are any assets available to sell for the benefit of Creditors of the Bankruptcy Estate and then distributes the proceeds from any sale among the Creditors. The majority of Chapter 7 cases will not have any assets available to distribute to Creditors and will be termed “no asset” cases.

Chapter 13: Chapter 13 is commonly known as a “reorganization” or “wage-earner repayment case.” In this type of Bankruptcy, a Debtor proposes a repayment plan called “The Chapter 13 Plan” to repay some or all of his/her debt. A local Chapter 13 Trustee is appointed to the case to act as the information gatherer for the United States Trustee. The Trustee acts as the Debtor’s “banker” during the term of the Chapter 13 Plan. A Debtor pays money to the Trustee each month and the Trustee distributes those funds to the Creditors according to the terms of the Chapter 13 Plan and applicable Bankruptcy law.

Chapter 12: Chapter 12 is available to individuals who make their living as family farmers or fisherman and operates like a Chapter 13.

Chapter 11: Chapter 11 is most commonly used to help businesses reorganize and repay their debts, but can be used in certain circumstances by individuals. Of the 1,181,016 individuals filing Bankruptcy in the United States in 2012, this Chapter was utilized in less than 1% of the cases.³

BASIC BANKRUPTCY PROCESS

The filing of any type of Bankruptcy proceeding should begin with a consultation with a Bankruptcy Attorney. While a Debtor can file a Bankruptcy case without an attorney, it is not recommended. The waters of the Bankruptcy Code can be difficult to navigate without the guidance of an experienced professional.

The Debtor or the attorney will prepare documents outlining the Debtor’s income, expenses and any real estate or personal property the Debtor has an interest in, along with its value. The documents will also identify all of the Debtor’s Creditors. If the Debtor is filing a Chapter 11, 12, or 13, a Plan of Reorganization will also be prepared. The documents will be

³ www.uscourts.gov/statistics/BankruptcyStatistics.aspx

filed with the Bankruptcy Court in the Debtor's region. A case number will be assigned and a local Trustee will be appointed.

The Bankruptcy Court will send notice to all Creditors that a Bankruptcy petition has been filed and that the Automatic Stay is in effect. Just as the Chinese built the Great Wall of China to protect against invasions from its enemies, the Automatic Stay protects Debtors from "attacking" Creditors. The Automatic Stay is an Order of the Bankruptcy Court that shields Debtors from ALL actions Creditors may take to collect a debt owed to them. A Creditor may not contact a Debtor by any means. A creditor may not begin litigation against the Debtor, garnish the Debtor's wages or bank accounts to recoup funds owed to them, foreclose on or repossess the Debtor's property, or take any other action against the Debtor to collect the debts owed. The Creditor must either wait until the Bankruptcy Case is closed to collect any portion of its non-discharged debt or it must petition the Court to lift/vacate the automatic stay and allow it to pass through the wall to collect the debt. A Creditor pursuing collection action without permission from the Court takes the risk of being monetarily sanctioned by the Bankruptcy Court for violating the automatic stay.

Upon receipt of the Bankruptcy petition filing, the Bankruptcy Court Clerk's office will schedule an initial hearing before the Trustee assigned to handle the case. This initial hearing is called the Section 341 First Meeting of Creditors. The Debtor and attorney are required to attend the hearing so that the Trustee and Creditors may question the Debtor regarding his/her financial situation and the documents filed with the Court. If a Creditor wishes to attend this meeting and ask questions, counsel should be engaged to represent the Creditor in order to assure that all possible questions are asked of the Debtor relative to the Debt and the Bankruptcy Code. In a Chapter 11, 12, or 13 case, this initial hearing will be followed by a second hearing at a later date

called a Confirmation Hearing. Future articles in this series will address the Bankruptcy Process in more detail with respect to each of the common Bankruptcy Chapters.

Once the Trustee and all Creditors have reviewed the Bankruptcy Case, settled all matters with the Debtor and the Debtor has fulfilled all requirements under the Bankruptcy Code, the Debtor will receive a Discharge of the Bankruptcy. A Discharge in a Bankruptcy Case releases the debtor from personal liability as to all debts that are dischargeable as set forth in the Bankruptcy Code as of the date that the bankruptcy petition was filed. The Discharge prevents Creditors from taking any actions against the Debtor to collect the discharged debt (e.g. telephone calls, letters, personal contact, litigation, etc.). In the event that a Bankruptcy case is dismissed (which can occur for a number of different reasons), a Discharge will not be entered and Creditors can pursue the Debtor to collect the debts owed, unless the Debtor files another Bankruptcy Case.

While Creditors cannot stop a Debtor from filing for Bankruptcy, as the Debtor has a legal right mandated by Federal Law, Creditors can insure that their rights are preserved during the Bankruptcy Process. A Creditor should consult an experienced bankruptcy attorney to review the documents filed by the Debtor and to determine all of the remedies available to the Creditor pursuant to the Federal Bankruptcy Code.