

# **How Bankruptcy Changes the Landscape**

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# The Automatic Stay

- The Bankruptcy Code protects debtors from actions by their creditors by imposing an “automatic stay” against actions to collect their debts.
- Set forth in 11 U.S.C. § 362
- The purpose is “to facilitate the orderly administration of the debtor's estate.”

# The Automatic Stay

- The automatic stay operates as a stay, applicable to all entities, of:

# The Automatic Stay

- 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*

# The Automatic Stay

- 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*

# The Automatic Stay

- 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*

# The Automatic Stay

- 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*

# The Automatic Stay

- 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;



# The Automatic Stay

- 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...*

# The Automatic Stay

- 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

# The Automatic Stay

- When does the Stay NOT Come into Effect?
  - Repeat Filings

# The Automatic Stay

- One Prior Filing § 362(c)(3)
- Stay Terminates after 30 Days
- Can be Extended upon:
  - Motion and Hearing Prior to Expiration
  - Showing of Good Faith

# The Automatic Stay

- Presumption of No Good Faith § 362(c)(3)(C)
  - More than One Prior Case in Past Year
  - Prior Case Dismissed after Debtor Failed to Take Certain Acts
  - No Substantial Change in Financial Position
  - When Previous Case Dismissed while Prior Stay Relief Motion Pending

# The Automatic Stay

- Two or More Prior Filings § 362(c)(4)(A)
  - No Stay upon Filing
  - Stay can be Ordered Into Effect upon Motion and Showing of Good Faith

# The Automatic Stay

- 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.

# The Automatic Stay

- Any party in possession of Property of the Estate must deliver to or account for such property to the Trustee appointed in the case. § 542



# 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.
- Filing by one spouse independently does not stay action against the other spouse.
- Does not protect business entity

# Co-Debtor Filings

- The exception: 11 U.S.C. § 1301
- Creates a “co-debtor stay” that bars actions to collect consumer debts from non-debtor co-debtors
- Only applies in Chapter 13 cases.
- Applies only to individuals.

# Co-Debtor Filings

- Exceptions:
  - such *individual* became liable in the ordinary course of their business; or
  - the case is closed, dismissed, or converted to a case under chapter 7 or 11.

# Co-Debtor Filings

- Relief will be granted when--
  - The Co-Debtor received the consideration for the claim;
  - The plan filed by the debtor proposes not to pay the claim; or
  - The creditor's interest would be irreparably harmed by continuation of such stay.

# Violation of the Automatic Stay

- If the automatic stay provisions are violated, substantial penalties may be assessed against the creditor and possibly their attorney.
  - An individual injured by any willful violation of the Stay shall recover actual damages, including costs and attorneys' fees, and
  - in appropriate circumstances, may recover punitive damages.

# Chapter 7

- The most common type of bankruptcy filing in the U.S.
  - 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.

# Chapter 7

- 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.
- May be authorized to continue the debtor's business to increase the return to creditors – but this is not common.

# Chapter 7

- A Debtor's typical motivations for filing a Chapter 7 case:
  - to stop collection efforts,
  - retain exempt property, and
  - receive a discharge of its debts.



# Chapter 7

- A Chapter 7 discharge
  - releases individual debtors from personal liability for most debts and prevents creditors from taking any collection actions against the debtor.
  - Discharge typically granted within 60 to 90 days from the meeting of creditors.
  - Non-individual debtors do not receive a discharge and are simply dissolved.

# The Trustee

- A Trustee is appointed in all Chapter 7 Cases.
  - The trustee's role is to administer the case, take control of the assets, and liquidate the debtor's non-exempt assets
  - If non-exempt assets exist, the trustee's duty in liquidating them is to maximize the return to the unsecured creditors

# The Trustee

- The trustee may:
  - attempt to recover money or assets under the trustee's avoiding powers;
  - set aside preferential transfers made to creditors within 90 days before the petition;
  - undo security interests not properly perfected;
  - pursue claims such as fraudulent conveyances available under state law; and
  - pursue any lawsuits or causes of action the debtor possesses at the time the case is filed.

# Proof of Claim

- To participate in any distribution by the Trustee, a creditor will need to file a proof of claim.
  - Typically have 90 days from the creditors meeting to file a claim.
  - If assets are discovered in a no-asset case, a notice will be issued.
  - A secured creditor does not forfeit its security interest or lien by failing to file a claim.

# No-Asset Cases

- Most Chapter 7 cases are no asset cases.
  - “No Asset” Report if the debtor lists no non-exempt assets in its schedules, and it appears that there are no other assets after the meeting of creditors.
  - No distribution to the creditors
  - Debtor is awarded a discharge

# Reaffirmation Agreements

- Provides that Secured creditor retains their rights in property after discharge is granted.
- Debtors seeking to retain the property may reaffirm the debt.
- Debtor remains liable on the debt after discharge.
- Creditor agrees not to foreclose as long as the debtor continues to pay.

# Reaffirmation Agreements

- Requirements set out in §524(c)
  - Must be filed prior to discharge
  - Required Disclosures
  - Subject to Court Approval
  - Must be signed by parties and counsel
  - Debtor may rescind prior to discharge or up to 60 days from execution.

# Discharge

- Debtor's ultimate goal
  - Absolves Debtor from personal liability from discharged debts
- Discharge granted unless:
  - Debtor Fails to meet statutory requirements
  - AP is filed opposing discharge
  - Debt falls into category of nondischargeable debts



# Denial of Discharge Under §727(a)

- Transfer or removal of property of the estate;
- Failure to produce adequate financial records;
- Making of false statements in connection with the bankruptcy filing;
- Failure to adequately explain loss of assets;

# Denial of Discharge Under §727(a)

- Commission of a bankruptcy crime such as perjury;
- Failure to obey a lawful order of the bankruptcy court;
- Fraudulently transferring, concealing or destroying property of the estate; and
- Recent grant of a discharge to Debtor in case where the majority of debt not paid.

# Debts Excepted from Discharge under §523

- Debts for:
- Certain taxes;
- Money obtained through fraud or the use of false statements (fraudulent credit app.);
- Fraud while the debtor was acting in a fiduciary capacity;
- Child or domestic support;
- Certain willful injuries;

# Debts Excepted from Discharge under §523

- Certain governmental fines and penalties;
- Student loans;
- Deaths caused by debtor's operation of a motor vehicle while intoxicated;
- Alimony;
- Criminal restitution and certain other governmental obligations; or
- Debts not disclosed at the time of filing.

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# Debts Excepted from Discharge under §523

- Debts discharged unless the creditor files an AP and obtains a court determination:
- (a)(2) – Money obtained through false statements regarding the debtor’s financial condition;
- (a)(4) – Fraud or defalcation while the acting in a fiduciary capacity; and
- (a)(6) Willful and malicious injury.

# Chapter 13

- Provides for the readjustment of the debts of individuals with regular income.
- Allows the Debtor to submit a plan that commits some portion of the debtor's future income to pay creditors for 3 to 5 years.
- Must have less than \$336,900 of unsecured debt and less than \$1,010,650 in secured debt.

# Chapter 13 Trustee

- Oversees the administration of the bankruptcy case, confirmation, and execution of the Plan.
- Receives and disburses the debtor's monthly payments.
- 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 powers of a Chapter 7 trustee.

# Advantages of Chap 13

- Debtor has the opportunity to save its home from foreclosures and vehicles from repossessions.
- Delinquencies can be cured over time.
- Debtor can reschedule secured debts (other than a mortgage on the primary residence).
- Can extend payments over the life of the Chapter 13 plan.
- May alter interest rate on debts other than mortgage debt.



# Means Test

- Certain individuals may not qualify to file under Chapter 7.
- Individuals with majority consumer debt and incomes exceeding the median family income.
- Debtor provides financial information to the trustee to make the determination.
- Also used to determine whether the length of the debtor's Chapter 13 plan will be 3 or 5 years.

# Chapter 11

- Business reorganizations and liquidations.
- Both individuals and entities may file.
- Debtor-in-possession (DIP) remains in control of assets and manages business subject to oversight.
- DIP owes a fiduciary duty to creditors and the bankruptcy estate.
- DIP exercises most powers of a Chapter 7 trustee.
- Trustee may be appointed in situations involving fraud, dishonesty, or incompetence of the DIP.

# Chapter 11 Plan

- Purpose of Chapter 11 is to allow the filing and confirmation of a plan of reorganization.
- Allows the debtor to emerge from bankruptcy with restructured debt.
- Operates as a contract between the debtor and all creditors.
- Supersedes any prior agreements.
- Often alters repayment terms.
- May provide for the orderly liquidation of the DIP and its assets.

# Use, Sale, or Lease of Property of the Estate

- Section 363 authorizes the trustee to use, sell, or lease any property of the estate.
- If outside of the Debtor's normal course of business, Trustee must first get court approval.
- Trustee can't use or sell "cash collateral" without the consent of secured party or court approval.
- Party with an interest in other property may petition the court prohibit use or sale or to condition use as necessary to protect interest.

## §363 Sale

- Term is often used to describe the trustee's sale of property free and clear of liens or interests.
- Can be very attractive to a potential purchaser.
- Sale will be accompanied by Order establishing that purchaser now holds the property free of any pre-existing liens or interests.
- Bankruptcies are sometimes filed for the primary purpose of conveying property free of competing liens or interests.

# §363 Sale

- Requirements--
  - applicable nonbankruptcy law permits sale of such property free and clear of such interest;
  - such entity consents;
  - such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
  - such interest is in bona fide dispute; or
  - such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

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# §363 Sale of Jointly Owned Property

- Partition in kind of property among estate and co-owners is impracticable;
- Sale of the estate's undivided interest would realize significantly less than sale of property free of the interests of co-owners;
- Benefit to the estate outweighs the detriment to co-owners; and
- Property is not used in the production, transmission, or distribution, for sale, of electricity or gas.

# §363 Sale of Jointly Owned Property

- If power is exercised, Trustee must distribute to the co-owner the proceeds of the sale – less costs and expenses – according to such co-owner's interest.
- Before sale is completed the co-owner has the right to purchase the entire property at the sale price.



# Chapter 9

- Municipal Bankruptcies
- Rare
- Similar to Chapter 11
- Only certain provisions of Chap 11 apply
- Jefferson County

# Chapter 12

- Bankruptcy for family farmers
- Rare in Alabama
- Common only in a few heavily agricultural states

# Post-Foreclosure Sale Bankruptcy Filing

- Does not impact the foreclosure.
- Foreclosed property is no longer property of the estate after the sale is completed.
- True even if the foreclosure deed has not been recorded at the time of the bankruptcy filing.
- Redemption right becomes property of the estate and can be exercised by the Trustee

# Relief from the Automatic Stay

- 11 USC § 362(d) allows creditors, in certain circumstances, to obtain relief from the automatic stay and proceed with foreclosure or repossession after a bankruptcy filing.
- Only granted after the filing of a motion, notice, and a hearing.

# Grounds for Stay Relief

- For CAUSE, including (*but not limited to*)
  - Lack of Adequate Protection of an interest in property of a party in interest.
  - Hazardous condition
  - Lack of insurance
  - Bad Faith filing
- Intentionally broad and flexible concept which must be determined on a case by case analysis

# Grounds for Stay Relief

- With respect to a stay of an act against property of the estate, if--
- (A) the debtor does not have an equity in such property; and
- (B) such property is not necessary to an effective reorganization.

# Grounds for Stay Relief

- (A) the debtor does not have an equity in such property
  - Shifting Burden
    - Movant has initial burden to make prima facie showing of cause
  - Impact of Additional liens
  - Common Types of Evidencence

# Grounds for Stay Relief

- (B) such property is not necessary to an effective reorganization.
  - Automatically met in Chapter 7 Cases or Chapter 11 Cases under Liquidating Plan
  - Shifting Burden
  - Deference often given to Debtor



# Grounds for Stay Relief

- Provisions in Forbearance Agreements Providing for Stay Relief may be Enforced when Supported by Consideration
  - *In re Excelsior Henderson Motorcycle Manufacturing Company, Inc.*, 273 B.R. 920, 924 (Bankr. S.D. Fla. 2002)
  - *In re Club Tower, L.P.*, 138 B.R. 307, 310-11 (Bankr. N.D. Ga. 1991)

# Grounds for Stay Relief

- If the court finds under §362(d)(4) that the filing of the petition was part of a **scheme to delay, hinder, or defraud creditors** that involved either
  - transfer of all or part ownership of, or other interest in, such real property without the consent of the secured creditor or court approval; or
  - multiple bankruptcy filings affecting such real property.
- Order will remain Binding in other cases affecting such real property for 2 years if properly recorded in real property records.

# Grounds for Stay Relief

- With respect to Single Asset Real Estate, if within 90 days of filing the Debtor has not:
  - Filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or
  - commenced monthly payments that are equal to interest accruing at the the nondefault contract rate of interest on the value of the creditor's interest in the real estate.

# Dismissal of Case

- Grounds under §1112(b)
  - Bad Faith
  - Abuse
- Timing Considerations
- Impact

**Questions?**

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**Thank You**

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