Concurrent Session

ABCs of Representing Consumers in Bankruptcy Cases

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POTENTIAL MALPRACTICE PITFALLS IN BANKRUPTCY

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POTENTIAL MALPRACTICE PITFALLS IN BANKRUPTCY

This outline is intended to provide the reader with a general overview of potential mine fields which need to be maneuvered in representing a bankruptcy debtor. It is designed to assist a lawyer in avoiding both common and unusual bankruptcy mistakes.

A. INITIAL CONFERENCE MISTAKES

You need to be on the alert from the very beginning in representing a bankruptcy debtor, starting with the very first contact you have with that individual or business. The following is an itemization of concerns you should have from the inception of the relationship.

1. Institute a screening system – before the client gets in the door, make sure you really want the person as your client. I actually have two staff members who screen potential clients before an appointment is scheduled. My staff is trained to ascertain from the potential client his concerns and expectations, and if they are not realistic, an initial consultation is not scheduled. My assistants are especially sensitive to potential clients who already have representation and are seeking to change attorneys, though my staff is also familiar with which lawyers seem to have problems retaining clients. Potential clients are also warned about probable fees before they arrive since we do not want individuals to attend initial consultations just to discover that they cannot afford our rates.

2. Run a comprehensive conflict search – no one should be allowed to meet with you until a comprehensive conflict search has been completed. Because conducting a complete

conflict search is time intensive, my assistants are trained to screen potential clients and another reason why we charge for our initial consultations.

3. Recognize potential conflicts when meeting with clients – if a husband and wife appear to not be in accord, explain to them that your ability to represent both is conditioned upon them agreeing with the strategy you are outlining. In certain cases, if the relationship is strained, you would want them to seek independent counsel to approve the joint representation. When two or three co-owners of a business appear at your office, you need to alert the individuals as to whom or what you will be representing. If they want you to represent a business, you need to explain to them that you may not be able to represent them individually or, if they prefer you represent them individually, that they are aware of the potential conflicts. Oftentimes the conflicts are reconcilable, but only if there is full disclosure from the onset. Finally, recognize situations in which even though a new client may not have a current conflict with an existing client, a conflict may arise.

4. The supervising lawyer should meet with the client at the initial consultation – if you are in a high volume practice, this can be difficult to do, but you need to have a supervising or responsible lawyer meet with every potential client. The client deserves to meet with his lawyer, but more importantly, the lawyer needs to know whom he'll be representing. Over the years, I have refused to accept certain clients after talking to that person at the initial consultation.

5. You need to provide the statutory disclosures – the Reform Act specifically provides that unless your client receives the statutory disclosures, your right to be paid can be challenged. I make every client sign a copy of the disclosures for my file just in case we are ever audited. I fully understand that a lot of the verbiage in the disclosures borders on the nonsensical, but Congress, in its infinite wisdom, enacted this requirement and you should abide by it.

6. Consider non-bankruptcy alternatives – you need to have a working knowledge of other areas of the law including foreclosure and joint and several liability, because in many cases bankruptcy is not necessary. If your client owns non-recourse real estate, there may not be a reason to put him into bankruptcy. Especially when third parties may be involved or responsible, alternatives short of bankruptcy may be available. When a distraught ex-wife appears in your office and is contemplating bankruptcy because her ex-husband has now filed for bankruptcy and has left her with debts for which he has specifically indemnified her, she may be able to avoid bankruptcy by enforcing those rights under 11 U.S.C. § 523 (a)(15).

7. Meet both the husband and wife – many years ago I was retained by a woman who unfortunately proved to be a pathological liar. She managed to deny me access to her husband with a variety of believable excuses, but fortunately I was able to track him down. You can well imagine his surprise, disappointment and anger when he was advised that his family was 18 months behind on mortgage payments, was facing foreclosure, and had been in chapter 13 for six months. I was able to avoid embarrassment since I had not originally filed the case,

but I learned my lesson. Make it mandatory that prior to the bankruptcy filing a responsible person from your office has direct contact with both spouses.

8. Define the scope of initial consultation – every client who meets with anyone at my firm receives an e-mail confirmation limiting the scope of the representation to the initial consultation. This could be invaluable when a potential client starts telling creditors that you represent him after the initial consultation without retaining you. It also eliminates potential conflicts if, at a later date, you are retained by an adverse party on an un-related matter.

9. Consider all timing issues – ask questions about pending foreclosure dates and answer deadlines and other statutory periods. The client needs to understand unequivocally that until you are retained, he remains at risk. However, unless you have some idea as to the pending deadlines, it's difficult to advise clients as to the urgency of the situation.

10. Bring up tax implications at the initial conference – I always tell clients I am not a tax attorney nor am I qualified to render advice in that regard and I make it a practice to always warn clients that they need to speak to a tax expert in deciding whether or not to proceed. Many potential clients will tell me how they have been able to work out very good settlements on a large amount of debt, but do not realize that they may be facing devastating 1099s and non-dischargeable ordinary income taxes triggered by debt forgiveness.

B. COMMON MISTAKES ONCE RETAINED

1. Have a written fee agreement – make sure your client signs a written fee agreement. It should be in layman's terms and break down what may be covered by a fixed fee and how much is charged for work beyond the initial scope of the agreement.

2. Use a CYA letter – if you are handling primarily simple and routine bankruptcies, the CYA letter may be relatively short and consist of primarily boilerplate. Nevertheless, use it. Even the simplest cases have many nuances, and relying purely upon forms can lead to major boondoggles.

3. Explain "property of the estate" – because of the potential ramifications of a client not understanding this concept, I provide the information to clients in three different forms. I give them a form which outlines their exemptions, each receives a boilerplate provision explaining discrete issues that may arise concerning property of the estate, and I then incorporate a discussion about the client's specific situation. Even with all of this background, you need to be prepared to further clarify this issue.

4. Explain exemptions – every client receives my personalized discussion on exemptions, and then a specific overview of the client's situation. Make sure your client is eligible to use Arizona exemptions. If he is not, then you need to be prepared to engage in a rather in-depth analysis about which state's exemptions he can use, if any at all. If your client has sold his homestead before filing and is holding onto homestead proceedings, confirm your

client understands that he has 18 months to spend those homestead proceeds from the date of the house sale and that current case law suggests that the money must be earmarked for that purpose. You also want to make sure to claim the entire exemption amount, even if the asset is worth less, and finally, don't let your client transfer exempt property assets in advance of bankruptcy if such a transfer is fraudulent or preferential. If it is, case law provides that the assets will be returned to the bankruptcy estate and, in almost all cases, the debtor will not be able to claim the exemption.

5. Explain prebankruptcy planning – I now provide every client with a detailed explanation of prebankruptcy planning which requires over a page. I then speak about the client's specific situation and let the client decide how to proceed. I do not tell clients to engage in prebankruptcy planning; I simply explain to them the option and let them make the decision.

6. Explain eligibility – a client needs to understand that he may not be eligible for Chapter 7, and if he is not eligible, why he is not. At the same time, that client should be aware of reorganization options.

7. Explain the differences between Chapter 11 and 13 if eligibility is an issue – an in-depth discussion about the benefits of Chapter 11 over Chapter 13 is beyond the scope of this presentation, but it is something that should be considered if the client is not eligible for Chapter 7.

8. Explain setoff rights – it may be weeks, if not months, before your client actually files for bankruptcy protection. Your client will be very disappointed if his bank seizes his money because you did not warn the client about statutory and contractual setoff rights.

9. Explain the dischargeability concept – your client may not have one challenge mounted to any specific debt, but your client needs to understand this concept.

10. Explain the discharge concept – once again, your client may not have any discharge issues, but he needs to be aware of what this means.

11. Explain the reaffirmation process – before filing, your client needs to understand his options under the law.

12. Explain issues with surrendered real estate not foreclosed upon – until a foreclosure is completed by a lender, your client retains title to real estate in his name. He could easily get stuck with excessive homeowner association assessments, or even worse, be facing a postbankruptcy liability claim.

13. Confirm how your client owns assets – if your client wants to advance exemption rights, you need to make sure that the asset is owned by the debtor. With the exception of the homestead exemption, which can be asserted on a home titled in a living trust, assets titled to an L.L.C. or corporation cannot be exempted by the debtor.

14. Explain preferences – since oftentimes bankruptcies may not be filed for many months, if your client wants to avoid the reversal of a payment, he needs to understand the concept of preferences. Furthermore, you do not want your client to engage in excessive preferential transfers before bankruptcy because your client may be depleting funds he could devote to other purposes and, in certain instances, could lead to a discharge challenge.

15. Explain fraudulent transfers – all too often, a debtor has no idea that transfers to children that may have been appropriate under the gift tax laws are impermissible transfers. Your client needs to understand this concept so he does not continue this practice as bankruptcy nears and understands what may happen as to transfers that have already occurred.

16. Explain the Trustee's role in the process.

17. Explain the difference between a case closing and a discharge.

C. MISTAKES TO AVOID ONCE A CASE IS FILED

1. Prepare your client for the first meeting of creditors – the first meeting of creditors may be the first time your client has ever appeared at a legal proceeding. As importantly, since the Trustee may ask your client some unexpected questions, or a creditor may appear, ensure your client knows what to expect and understands why he is there.

2. Amend the schedules promptly – if an asset or obligation was missed in the initial schedules, take the extra time to ensure that the schedules are amended promptly.

3. Seek abandonment of encumbered real or personal property your client wants to keep – even today, attorneys do not understand that an increase in the value of an asset prior to abandonment belongs to the bankruptcy estate. To minimize the chances that your client may have to turn over an asset because of appreciation during the administration of a case, procure an abandonment order early in the proceeding. In 2004 through 2006, many debtors lost their homes because their attorneys disregarded this rule.

4. Timely reaffirm secured debts – current 9th circuit case law provides that, unless the debtor at least tries to reaffirm a secured personal property debt, the creditor has the absolute right to repossess the collateral even if the loan is current.

5. Do not have your client reaffirm debts unnecessarily – if not statutorily mandated, don't have your client reaffirm a secured debt. If he does and defaults, the creditor will have full recourse against the debtor as though the bankruptcy had never been filed.

D. RED FLAGS IN CHAPTER 11 AND 13

1. Assume commercial real estate leases within 120 days or obtain an extension to assume – if your client fails to timely assume such a lease and the lease is then rejected, the landlord can require your client to surrender the premises even if current.

2. Understand the absolute priority rule in Chapter 11s – your client will not be entitled to retain his equity position in a non-personal Chapter 11 unless all creditors are paid in full, new value is contributed into the plan, or creditors consent to a disruption of the absolute priority rule.*

3. Procure approval of impaired class in Chapter 11s – in all Chapter 11s, unless you procure approval of an impaired class, the plan cannot be confirmed without the consent of all creditors.

4. Understand when payments begin – in a Chapter 13. the first payments begin thirty (30) days from the filing of a case, whereas in a Chapter 11, payments do not begin in most cases until confirmation of the plan.

5. Be fluent with the new Supreme Court decision on calculating plan payments in a Chapter 13 – the *Jan Hamilton, Chapter 13 Trustee, Petitioner v. Stephanie Kay Lanning* decision from a little over a week ago ruled that plan payments are based upon anticipated or projected monthly income, not by considering disposable income for the six months prior to the bankruptcy filing.

6. Remember the plan must almost always be at least five years long.

* Not needed in personal Chapter 11s.

7. Warn your clients about the impact of additional income during the course of a plan – in Chapter 13s, it is supposed to be contributed into the plan, though the same may not be true in Chapter 11s.

8. Outline for your clients which expenses are authorized – you do not want your clients to be surprised to discover that certain expenses they have been paying their whole lives cannot be paid in a reorganization case.

9. Alert clients about potential dischargeability issues.

10. Explain the fee application process in a Chapter 11 or 13, unless the fees in a Chapter 13 fall under the cap amount.

11. Give your client a breakdown between transactions that are ordinary and do not require court approval and those that do.

12. Alert clients of the need to procure court approval of most professionals.

13. Explain to them the restrictions on paying professionals.

14. Warn them about the strict guidelines in a single asset real estate case.

This overview is not intended to be all exhaustive or to suggest that other problems may not arise in a bankruptcy case. Nonetheless, if you consider the matters covered in this presentation, you will have substantially reduced the chances that your case goes awry.

ABCs of Representing Consumers in Bankruptcy Cases

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EXAMINATION OF BANKRUPTCY LAWS AND PROCEDURES
RELATING TO CHAPTER 7 CONSUMER BANKRUPTCIES

1) Bankruptcy Code

a) Title 11 of the United States Code is referred to as the Bankruptcy Code. The Code consists of odd numbered chapters, except for Chapter 12. Chapters 1, 3 and 5 contain provisions which may apply to all types of bankruptcy and the remaining chapters are outlined below:

Chapter 7	Liquidation
Chapter 9	Adjustment of Debts of a Municipality
Chapter 11	Reorganization
Chapter 12	Adjustment of Debts of a Family Farmer or Fisherman with Regular Income
Chapter 13	Adjustment of Debts of an Individual with Regular Income Wage Earners
Chapter 15	Ancillary and Other Cross-Border Cases

b) Chapter 7 Eligibility:

i) Who may be a debtor?: 1) A Debtor must reside in the U.S., or 2) be a person with a domicile, place of business or property in the U.S., or 3) be a municipality. 11 U.S.C. § 109(a).

ii) A "person," including individuals, partnerships and corporations may file Chapter 7. 11 U.S.C. § 109.

iii) A person is not eligible for a discharge under Chapter 7 if the Debtor has received a discharge in a previous Chapter 7 case filed less than eight years prior to the subsequent case being filed.

iv) A person is eligible for discharge under Chapter 7, even if it is filed less than six years after a prior Chapter 13 and if the prior Chapter 13 paid 70-100% of the allowed unsecured claims or upon court approval. 11 U.S.C. § 727(a)(9).

Procedural Law

b) The Federal Rules of Bankruptcy Procedure ("FRBP") and forms govern procedure in cases under Title 11 of the U.S. Code.

Section Nos.	
1001	Scope of Rules
1002-1021	Commencement of Case; Proceedings Relating to Petition and Order for Relief
2001-2020	Officers and Administration; Notices; Meetings; Examinations; Elections; Attorneys and Accountants
3001-3022	Claims and Distribution to Creditors and Equity Interest Holders; Plans
4001-4008	The Debtor; Duties and Benefits
5001-5012	Courts and Clerks
6001-6011	Collection and Liquidation of the Estate

7001-7087	Adversary Proceedings
8001-8020	Appeals to District Court or Bankruptcy Appellate Panel
9001-9037	General Provisions

c) Local Rules – check the district website

d) Official Forms

i) Petition and Schedules

- Voluntary Petition (revised 1/08)
- Exhibit A to Voluntary Petition
- Exhibit C to Voluntary Petition
- Exhibit D to Voluntary Petition (revised 12/08)
- Summary of Schedules (revised 12/07)
- Schedule A (revised 12/07)
- Schedule B (revised 12/07)
- Schedule C (revised 12/07)
- Schedule D (revised 12/07)
- Schedule E (revised12/07)
- Schedule F (revised 12/07)
- Schedule G (revised 12/07)
- Schedule H (revised 12/07)
- Schedule I (revised 12/07)
- Schedule J (revised 12/07)
- Declaration Concerning Debtor's Schedules (revised 12/07)

ii) Forms

- Statement of Financial Affairs (revised 12/07)
- Debtor's Statement of Intention (revised 12/08)
- Statement of Social Security Number(s) (revised 12/07)
- Statement of current monthly income and means-test calculation (Chapter 7) (revised 12/08)
- Debtor's Certification of Completion of Financial Management Course (revised 12/08)
- Notice to Individual Consumer Debtor (revised 12/08)
- Disclosure of Compensation of Attorney for Debtor (revised 1/04)
- Payment Advices Cover Sheet

THE BANKRUPTCY PROCEEDINGS

1) Pre-filing considerations

The initial conference is an opportunity to gather the facts necessary for determining the appropriateness of the filing and the information needed for filing. This information is then entered into the bankruptcy petition, schedules and forms for review by the attorney.

A system for collecting the information assists in the accuracy of the filed documents.

a) Initial conference

i) Client folder includes:

(1) Fee Agreement

(2) Initial Client Interview Checklist

(3) Client Information Checklist

(a) Client should be advised to contact the office upon completion of the client information checklist.

(4) List of Credit Counselors from UST website.

(5) Business Cards

ii) At the initial meeting, there is a fine line between getting too much information and overwhelming the client and not getting enough information in order to assess the appropriate time to file (activities which trigger preferences or fraudulent conveyances).

iii) A determination should be made during the discussion of the fee agreement regarding the amount of fees required prior to filing.

iv) If you use a bankruptcy software program, it is important to begin entering the information so you can track what information still needs to be received by the client and what requires further clarification.

v) Utilize early assessment, proper follow-up, and organization.

b) Follow-up meeting

i) Upon contact from the client, schedule an appointment to review the materials or have the materials forwarded to the paralegal for review, prior to a follow-up meeting.

ii) Confirm receipt of signed Fee Agreement.

iii) Confirm proper steps have been followed within your law firm's conflict check system. However, review the conflicts information to confirm all applicable parties are named within search. One extra minute or two to confirm conflicts analysis may save potential problems in the future.

iv) Organize materials received by the client following the schedules on your outline.

v) Do your homework.

(1) State court access systems for lawsuits and judgments.

(2) Real estate access websites for real estate ownership and mortgage recording information.

(3) Helpful Hint: Keep a separate folder of the various passwords established for Pacer, Tapestry, Landshark, Westlaw and Lexis.

2) Preparation of Petition

a) Name of Debtor: Include full name of Debtor, including Jr., Sr., or III designations within the name filed.

b) Other names: Include name of sole proprietorship within last eight years (i.e., trade name)

c) Social Security Number: only include last 4 digits as the records filed are public documents. If your office is using a bankruptcy software program, insert the entire social security number and the program should mask all but the last four digits.

d) Check appropriate box for "Nature of Debts." This should be consistent with documents provided by the client and coordinate with information provided on Schedules D, E and F.

e) Prior Bankruptcy: If the client has not provided a copy of its Discharge of Debtor and Final Decree, check Pacer for prior bankruptcy action information.

f) Exhibit D – It is important that if this is a joint petition, each spouse must complete and sign a separate Exhibit D. In addition, the actual Certificate of Counseling must be filed separately.

g) Signatures – The attorney should review the petition and schedules with the client prior to filing. The attorney must sign the section entitled Exhibit B. 11 U.S.C. § 342(b).

h) The attorney must also sign on page 3 of the Petition which confirms that the "attorney has no knowledge after an inquiry that the information in the schedules is incorrect." The attorney should spend time with the client, prior to obtaining signatures, to carefully review the schedules.

3) List of Creditors

The mailing matrix must be filed at the time of filing the petition. The Clerk's office uses the matrix to send notice to creditors and other interested parties. If your firm does not use a bankruptcy software package, which would automatically generate this page, then consult the local court rules regarding format.

4) Preparation of Schedules, Forms and Statement of Financial Affairs

a) Schedule A – Real Property

i) Note: Include legal description in Western District cases. Show the fair market value of the property and list the source of the value.

ii) Do not reduce the value by costs of sale.

iii) List amount of secured claim. This amount will be linked to Schedule D if using a bankruptcy software program.

b) Schedule B – Personal Property

i) Review list of every type of property with the client.

ii) Documents that may be of assistance in preparing the list include retirement statements, tax returns, life insurance declaration sheets, bank account statements, loan applications, credit card statements, possible refunds noted on tax returns, home owner's insurance policies with riders listing jewelry, furs, etc.

iii) Assets are to be valued at their current value as of the date of filing.

iv) If the debtor does not own a particular asset listed on Schedule B, place an "x" by none. Do not leave any asset classification blank. Also, an asset should not be listed as none, even if the asset has nominal value.

v) If the debtor wishes to be creative by placing lawn equipment or tools under "Machinery, fixtures, equipment and supplies used in business," to allow those items to be exempted in Schedule C, it may open up the door for the Trustee to review income and tax returns.

vi) Full disclosure is required.

c) Schedule C – Exemptions

i) Debtors may elect state or federal exemptions. A legal analysis of the federal or state exemption is usually reviewed by the attorney after you have completed a draft of the schedules.

ii) Prior to filing, do your math. Even if you utilize a bankruptcy software program, some exemptions may double when filing jointly when it is not proper to do so.

iii) Corporations cannot claim exemptions and therefore do not file Schedule C.

d) Schedule D – Creditors Holding Secured Claims

i) Obtain the supporting documents from the client.

ii) Confirm that the lien has been properly perfected.

iii) The value of the property should match the property listed in the schedules.

iv) If the debtor no longer owns the asset that was the collateral, then list the creditor on Schedule F.

v) The recording information for all mortgages and liens on personal property should be listed. Western District Local Rule 1007-1-2.

e) Schedule E – Creditors Holding Unsecured Priority Claims

i) Types of Priority Claims include: domestic support obligations or certain taxes and other debts owed to governmental units.

ii) List name of ex-spouse or parent/entity that receives child support.

iii) If you utilize a bankruptcy software program, every creditor listed on Schedules D, E and F will be included in the mailing matrix to receive Notice of Bankruptcy. The bankruptcy management software used by the Clerk, usually includes the Internal Revenue Service and the State Department of Revenue, but you may want to consider listing both agencies as a safety precaution.

f) Schedule F – Creditors Holding Unsecured Priority Claims

i) List all creditors including a complete address and at least the last four digits of the account number. If there is a co-debtor, check the box next to the named creditor and include the person or company on Schedule H.

ii) If applicable, check the box for contingent, unliquidated or disputed. Do not overlook this area.

iii) List approximate date when the debt was incurred and if the debt is business or personal debt.

iv) All unsatisfied judgments in the lawsuit should be included on Schedule F unless there is real estate equity to which a docketed judgment can attach.

v) List ex-spouses and partners, both personal and business who may be co-debtors.

vi) If using a bankruptcy software package, the entry of unsecured creditors is made much easier, especially for those debts which have a co-debtor or where additional notice to another party is necessary.

g) Schedule G – Executory Contracts

i) Types of executory contracts may include an apartment lease, vehicle lease and time share interests. Review time share documents carefully, as the debtor's interest in a time share may be included in Schedule A.

h) Schedule H – Co-Debtors

i) Types of co-debtors may include guarantors, co-signers, debtor's former spouse or perhaps a minor child. Do not disclose the minor's name and consult the instructions on this schedule on how to properly identify a minor.

i) Schedule I – Current Income of Individual Debtors and Schedule J – Current Expenditures of Individual Debtor

i) The schedules should include current income and expenses.

ii) The Trustee and the Office of the U.S. Trustee will cross-check this information with the data contained in the Debtor's tax returns, schedules and statement of financial affairs.

iii) If regular income from operating a business is noted on the form, attach a detailed statement. If this is not provided, the Trustee may not conclude the Creditors' Meeting.

iv) Provide explanation of increases or decreases anticipated by Debtor.

j) Form 22A - Statement of current monthly income and means-test calculation

i) File with the Petition. If not filed within 45 days of petition date, the case may be automatically dismissed. In addition, failure to file will cause Trustee to continue the § 341 meeting.

ii) Be consistent with the information provided on the petition.

iii) If debts are not primarily consumer debts, check the appropriate box on the form and verification section. However, be prepared to provide documentation of non-consumer debt.

iv) Look back six months (ending with the last day of the month before month of filing). While it may be initially easier to rely on the Debtor's comments as to income, look at the documents yourself.

k) Statement of Financial Affairs

i) The Debtor needs to respond to each question carefully and completely. Review this document carefully to make sure it coincides with information on Schedules. A member of your office will obtain the information and complete Question 9 regarding statement of fees paid.

ii) Pending lawsuits should be listed and should also be reflected on correct schedule.

iii) If bank accounts were closed, indicate how was the money distributed.

iv) If assets were sold, note accordingly and make sure the client understands the terms "preference" and "fraudulent transfers." These discussions usually occur at the initial meeting by the attorney, so read initial meeting notes and communicate with your attorney if you find anything to red flag.

l) Miscellaneous documents to be filed include:

i) Debtor's Statement of Intention – must be filed within 30 days of filing of the petition and needs to address all debts secured by property. It is best to file the statement of intention with the Petition, if possible.

ii) Declaration Concerning Debtor's Schedules.

iii) Declaration re: Electronic Filing. Mail the original to the court for filing.

iv) Statement of Social-Security Number or Individual Taxpayer-Identification Number.

v) Certificate of Debtor Education – must be completed and filed prior to receipt of discharge.

vi) Notice to Consumer Debtors under § 342(b) of the Bankruptcy Code.

vii) Disclosure of Compensation of Attorney for Debtor. Again check for consistency that it coincides with information on fee agreement and Statement of Financial Affairs, number 9. This document must be filed within 15 days of the Order for relief.

m) Amendments

i) When amending Schedule D, E or F to add a creditor, file a complete amended schedule, a revised mailing matrix and a signed Declaration Sheet. The fee is $26 with no cap on number of creditors added.

ii) When filing an amended Schedule B, you may need to also amend Schedule C, Amended Summary of Schedules, Statistical Summary of Certain Liabilities and a signed Declaration Sheet.

5) Motion for Relief and Abandonment

Immediately upon the filing of a bankruptcy petition, an automatic stay is put into place against efforts to collect prepetition debts, or to obtain or control debtor's property. 11 U.S.C. § 362(a). This means that the creditor cannot commence or continue a lawsuit, enforce a judgment, or perfect or enforce a lien. There are a certain number of actions barred by the automatic stay, the most common of which are criminal enforcement actions, certain family law matters and actions by governmental units. 11 U.S.C. § 362(b).

A creditor may file a Motion for Relief from Automatic Stay and Abandonment with the Court. This is most commonly filed by a secured mortgage lender or vehicle lien holder on the grounds that the debtor has no equity in the property, that it is decreasing in value or is not properly insured. The Trustee may object to the bankruptcy estate's abandonment of the asset but will allow the motion for relief from automatic stay. The Trustee may need additional time to ascertain the asset's value or determine that the asset has equity.

6) Debtors' duties

a) The debtor must comply by filing the required documents to initiate their bankruptcy filing. 11 U.S.C. § 521.

b) Seven days prior to the § 341, the Debtor must provide to the Trustee a signed copy of the most recently filed tax return. Tax returns are not to be filed with the court.

c) The debtor must appear at the first meeting of creditors (commonly referred to as the § 341 meeting) and answer the Trustee's questions, under oath, about the contents of the documents filed. 11 U.S.C. §§ 341, 343.

d) The Debtor must bring with him/her to the meeting of creditors, his/her social security card and picture identification card.

e) The debtor shall cooperate with the Trustee by providing additional information and documents if so requested. 11 U.S.C. § 521 (3) and (4).

Please instruct the client, in writing, to appear at the U.S. Trustee's office for the §341 meeting. While the address is clearly stated on the Notice of Chapter 7 Bankruptcy Case, it is not unusual for the Debtor to appear at the office of the Chapter 7 Panel Trustee, running late, much winded and totally confused regarding how to get from point A to point B.

7) The role of the Chapter 7 Trustee

a) When the Order for Relief is entered, an interim Trustee is appointed. 11 U.S.C. 701(a)(1). Appointment of the Trustee becomes permanent at the Meeting of Creditors, unless creditors elect a different Trustee at the Meeting of Creditors. 11 U.S.C. 702.

b) Duties:

i) Conducts the Section 341(a) meeting.

ii) Investigates the Debtor's financial affairs to determine if schedules and statement of financial affairs are completed in good faith.

iii) Statutory duties include:

(1) Collection and liquidation of assets, § 741(1)

(2) Accountability of the Trustee for all property received § 741(2)

(3) Examining the Debtor's exemptions and statement of intention, § 741(3)

(4) Investigate the financial affairs of the debtor, § 741(4)

(5) Examine proofs of claim, § 741(5)

c) Review of Debtor's attorney fees

d) Determination of no-asset cases

e) Liquidates non-exempt assets

f) Valuation of assets and review of Schedules C and D

g) Creditors and the Trustee have standing to object to claimed exemptions and bear the burden of proving that the exemptions are not properly claimed. Deadline to object to exemptions is 30 days after the meeting of creditors has been concluded, or 30 days after the filing of an amended or supplement to Schedule C. Rule 4003.

h) Acquires additional assets through avoiding powers

i) If successful, stands in the shoes of the creditor

ii) Review of Statement of Financial Affairs

iii) Preference payments (payments made within 90 days prior to date of filing)

iv) Transfers/Sale of Assets – insiders.

BANKRUPTCY CONCEPTS AND FUNDAMENTALS

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Early bankruptcy laws provided for violent and punitive results to debtors. In fact, the term "bankruptcy" is derived from the medieval practice in Italian city-states of breaking the benches of a merchant who may have left without paying his creditors. Under early English law, bankrupts were sometime hanged.

Today's bankruptcy laws are a far cry different. Perhaps this more lenient treatment of debtors accounts for what has been a generally steady increase in bankruptcy filings in this country.

The relatively dramatic increase in bankruptcy filings began with the passage of the 1978 Bankruptcy Reform Act. This act was the first major revision and overhaul of the 1898 Bankruptcy Reform Act and provides us with our current bankruptcy code. The code recently underwent its most extensive revision, with the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). Most of those amendments became effective October 17, 2005.

A. Basic Differences Between Chapter 7 and Chapter 13

1. Availability of Various Chapter Proceedings. The code comprises Title 11 of the United States Code and is divided into chapters. It was originally enacted with only odd-numbered chapters, being Chapters 1, 3, 5, 7, 9, 11, 13 and 15. The even-numbered chapters were left available for future amendments which Congress might enact. It did so in 1986, adding Chapter 12 to deal with the problems facing family farmers. Chapter 15 dealt with the United States Trustee and was deleted in 1986. Provisions regarding the United States Trustee are now located in Title 28. Chapter 15 has been recreated to deal with ancillary and cross-border cases.

Chapters 1, 3, and 5 contain general provisions applying to all bankruptcy cases. The remaining chapters deal with specific types of bankruptcies, as follows:

Chapter 7	Liquidation
Chapter 9	Municipal Bankruptcy
Chapter 11	Business Reorganization
Chapter 12	Family Farmers
Chapter 13	Wage Earners
Chapter 15	Ancillary and Cross-Border Cases

2. Chapter 7—Liquidation

a. Purpose. Chapter 7 provides an organized and orderly means of collecting and garnering the assets of the debtor, returning to the debtor those assets which may be exempt from execution and which the debtor is allowed to retain, and distributing the remaining assets to creditors. The debtor receives a fresh start by virtue of the discharge granted him.

b. Eligibility. Chapter 7 is available to all "persons," including "individuals," partnerships, and corporations. Railroads, insurance companies, and banking institutions may not file a Chapter 7 case. 11 U.S.C. §109. However, debtors above certain income levels may have to convert to Chapter 13 or face dismissal of their cases. 11 U.S.C. §707(b).

c. Functions. A Trustee is appointed as soon as a Chapter 7 case is commenced. The Trustee is to collect the debtor's property excepting that portion which is exempt in an individual case, and supervise the liquidation of that property. The Trustee has powers to invalidate certain types of both prepetition and postpetition transfers of the debtor's property, to avoid certain liens, and to contest creditors' claims. The Trustee is also required to distribute the cash proceeds of the estate property to the various creditors in the order of their priority as determined by the Bankruptcy Code. 11 U.S.C. §502.

d. Discharge. The granting of a discharge relieves the debtor from personal liability on prepetition debts. Only an individual may receive a discharge. Certain kinds of debts, however, may not be discharged. Under some circumstances, the debtor will receive no discharge at all.

Types of debts not dischargeable are set forth at 11 U.S.C. §523(a). They include the following types:

- Most types of taxes
- Debts incurred by fraud
- Debts incurred through false writings
- Certain credit card abuses, primarily cash advances and luxury items
- Unscheduled creditors
- Debts arising from fraud or larceny or defalcation while a fiduciary
- Alimony, maintenance, and child support (domestic support obligations) 11 U.S.C. §101(14A)
- Debts arising from willful and malicious injury
- Fines and penalties to a government unit
- Student loans under most conditions
- Debts arising from death or personal injury caused by operating a motor vehicle, vessel, or aircraft while intoxicated
- Debts denied discharge in a prior case

3. Chapter 13—Adjustment of Debts of an Individual With Regular Income

a. Purpose. Chapter 13 may be used for many purposes, but the goal of Congress in enacting it was to provide an incentive for people to avoid Chapter 7 liquidations and attempt to pay at least some dividend to creditors. To achieve that goal, Congress provided Chapter 13 debtors with certain advantages over those enjoyed by debtors in other chapters. Many of those advantages have been removed by BAPCPA.

b. Eligibility. Chapter 13 is available only to an "individual with regular income." Because of this, Chapter 13 plans are sometimes called "wage earner plans," but other persons may qualify if their income is sufficiently stable and regular to enable payments under a Chapter 13 plan. Self-employed persons often file Chapter 13 plans.

Chapter 13 also imposes debt limits which affect the eligibility to qualify for this relief. Those limits are imposed upon the debtor's indebtedness as of the date of the bankruptcy filing, as follows:

- $307,675 of noncontingent, liquidated, unsecured debt; and
- $922,975 of noncontingent, liquidated secured debt.

c. Functions. The debtor proposes a plan for repayment of his obligations. The plan must be filed within 15 days after the bankruptcy petition is filed (FRBP 3015(b)) , and the first plan payment is due within 30 days after the filing of the case. 11 U.S.C. §1326(a)(1). Plan payments shall be for three years unless the debtor's disposable income is above the median family income for a family of the same size. In that event, the plan must run for five years. 11 U.S.C. §1325(b)(4). In any event, the longest payment period permitted is five years. 11 U.S.C. §1322(d).

A Chapter 13 trustee oversees the case, but with a quite different role than the Chapter 7 trustee. The trustee's Chapter 13 role is to evaluate the plan for confirmation purposes. Once confirmed, the trustee receives plan payments from the debtor and distributes them in accordance with the plan. 11 U.S.C. § 1326.

The plan allows debtors to exercise significant creativity. The plan may not discriminate between creditors unfairly, and unsecured creditors must receive at least the value they would have received in a Chapter 7 liquidation. 11 U.S.C. §1325(a)(4). Secured creditors must either accept the plan, receive their collateral, or retain their existing liens and receive payments with a present discounted value at least equal to the value of the collateral. 11 U.S.C. §1325(a)(5). There are exceptions to this ability to strip-down liens when the liens are purchase money security interests. 11 U.S.C. §1325(a)(9).

No disclosure statement is provided to creditors and unsecured creditors do not vote on the plan. In practice, secured creditors do not vote on the plan either, although 11 U.S.C. §1325 refers to their acceptance of the plan. Generally, the plan is considered accepted if no objection is received. If the trustee or any unsecured creditor objects to the plan, the debtor is required to pay into the plan all of his "disposable income" for the applicable commitment period unless all claims are to be paid in full. 11 U.S.C. §1325(b).

d. Discharge. The Chapter 13 discharge is granted upon completion of the plan. The discharge is somewhat broader than that under Chapter 7. For example, debts arising from a divorce, but which are not in the nature of maintenance or support, may also be discharged. Chapter 13 debtors may also be able to pay unsecured tax debts without further accrual of interest or penalties.

Under some circumstances, the debtor may receive a discharge despite not having completed the plan. In those instances, the failure to complete the plan payments must be due to circumstances for which the debtor should not be held accountable, the creditors must have already received as much as they would have received under a Chapter 7 liquidation, and modification of the plan must not be practical. 11 U.S.C. §1328(b).

B. When to Use One As Opposed to the Other

1. Desire to Pay. Chapter 13 offers many advantages over Chapter 7. Some debtors truly wish to pay what they can toward their debts. They may be prevented from doing so because one creditor is aggressively pursuing its claims, such as by garnishment. In this instance, Chapter 13 can provide the necessary protection to the debtor, while at the same time allowing the debtor to pay his disposable income for distribution to his creditors.

2. Expanded Discharge. The discharge which a Chapter 13 debtor receives upon completion of his plan is somewhat broader than the discharge available under Chapter 7. Debts arising from a divorce, and which are not for maintenance or support, are dischargeable.

3. Reduction of Tax Claims. Tax claims that are not dischargeable in either a Chapter 7 or Chapter 13 case may nonetheless be more easily paid through a Chapter 13 Plan. The automatic stay under 11 U.S.C. Section 362 prevents lien filings or levies upon wages or assets. Moreover, the balance due upon tax obligations maybe paid without interest or penalty through a Chapter 13 Plan. This can result in substantial savings to the taxpayer/debtor.

Note though, that the tax claims must be paid in full through the Plan and that the IRS generally will not negotiate while a taxpayer is in bankruptcy. This refusal to negotiate removes the offer in compromise procedure as an option for the debtor.

4. Homestead Protection—11 U.S.C. §1322(b)(5). Under a Chapter 13 Plan, a debtor may cure and reinstate the original maturity on long-term debts. In re Clark, 738 F.2d 869 (7th Cir. 1984). Most often, these debts are notes secured by mortgages upon the debtor's homestead.

For example, debtor has a 30-year term upon his mortgage note with 27 years remaining. Unfortunately, the debtor has failed to make payments for the past 6 months and is now $3,000 in arrears.

Under §1322(b)(5), the debtor may cure that default over a reasonable time and reinstate the original mortgage and its original maturity. However, while curing the arrearage through the Plan, the debtor must continue to make all current payments due under the note directly to the mortgagee. Interest need be paid upon the arrearage only to the extent provided by the note and mortgage. 11 U.S.C. §1322(e). *In re Young,* 310 B.R. 127 (Bankr. E.D. Wis. 2004).

5. Lien Stripping of Secured Debt. A Chapter 13 debtor may bifurcate the claims of undersecured creditors. Thus, such creditor has a secured claim to the extent of the value of the collateral and an unsecured claim for the balance.

Under the Chapter 13 Plan, the debtor may pay the secured claim, with interest thereon to provide the creditor with the present value of the claim, while treating the unsecured claim along with all other unsecured claims. The practical effect is often such that the secured claim will be paid in full through the Plan, thereby releasing the lien upon the debtor's property serving as collateral, while the unsecured claim will receive a very small portion of the amount due.

Such lien stripping is not available in Chapter 7. *Dewsnup v. Timm*, 502 US 410, 112 S. Ct. 773. 116 L, Ed. 2d 903 (1992). Note also that such lien stripping and bifurcation is not available for claims secured only by a lien upon the debtor's residence. 11 U.S.C. 1322(b)(2). *Nobelman vs. American Savings Bank*, 113 S. Ct. 2106, 127 L.Ed. 2d 228 (1993).

6. Protecting Nonexempt Property. In Chapter 7 cases, all nonexempt property is liquidated with proceeds applied to administrative expenses and then distributed to creditors. In Chapter 13, a debtor may keep nonexempt property, provided the Plan satisfies the "best interests of creditors" test under 11 U.S.C. §1325(a)(4). This test requires that all claims be paid at least as much as they would receive in a Chapter 7 liquidation. Thus, the Chapter 13 debtor can retain nonexempt equity in property so long as the distribution to unsecured creditors is at least as great as the amount those creditors would receive in a Chapter 7.

For example, suppose the debtor has $5,000 worth of nonexempt equity in his vehicle. He does not wish to sell the vehicle and needs it for his employment. In a Chapter 7 liquidation the trustee would force the sale of the vehicle in order to distribute the proceeds to unsecured creditors. The Chapter 13 debtor, however, may retain the vehicle provided payments into the Plan for distribution upon unsecured claims total at least $5,000.

The Chapter 13 debtor need not retain all property, though, and may craft a Plan which provides for sale or surrender of various assets.

7. Protection of Codebtors. The automatic stay extends to codebtors of the debtor, at least with respect to consumer debts. The stay is limited, however, and applies only to the extent that the codebtor obligation is provided for by the Plan. 11 U.S.C. §1301.

In some districts, including the Western District of Wisconsin, Chapter 13 plans may provide for priority treatment of codebtor obligations. Thus, the codebtor obligations may be paid before other distributions to unsecured creditors.

The same result might be achieved in a Chapter 7 case, either by reaffirmation of the codebtor obligation or by payment of same by the debtor following discharge.

8. Eight-Year Discharge Bar. Chapter 13 filings are often necessary for debtors who have previously received a Chapter 7 discharge. A new Chapter 7 discharge may not be obtained within eight years of a prior Chapter 7 discharge, or in many cases, within six years of a prior Chapter 13 discharge. 11 U.S.C. §727(a)(9).

In fact, a Chapter 13 filing following a Chapter 7 filing is often planned even before the Chapter 7 filing. Such strategy is often beneficial and is allowed by law. *Johnson v. Home State Bank*, 501, US. 1216, 111 S. Ct. 2150, 115 L.Ed 2150 (1991).

9. Ability to Dismiss. Chapter 13 debtors have an absolute right to dismiss their case at any time. 11 U.S.C. §1307(b). This right can be very beneficial to debtors. It can provide enforced protection while negotiating with creditors, it can allow time to determine uncertain status of exemptions or marital property, and can allow time for the debtor to prosecute asset claims such as personal injury suit or collections.

Hint: A secured creditor who wishes to prevent a debtor from refiling (thus thwarting a repossession or foreclosure effort) may want to file a motion for relief. Then any voluntary dismissal by the debtor would preclude another filing for 180 days. 11 U.S.C. §109(g). The motion could probably even be filed after the debtor files his request for dismissal.

10. Excess Income. Chapter 13 may be required, or at least preferable to no bankruptcy at all, for debtors whose income is such that a presumption of abuse exists under the means test. 11 U.S.C. §707(b).

C. The Bankruptcy Estate

Note that such property includes any interest that the debtor might acquire within 180 days after the date of filing, by property settlement or divorce decree with the debtor's spouse, by inheritance, or as beneficiary of a life insurance policy. 11 U.S.C. §541(a)(5).

Property of the estate does not include funds in an education Individual Retirement Account (IRC §530(b)(1)) if those funds were placed in the account more than a year prior to filing, and subject to certain limitations. 11 U.S.C. §541(b)(5). Such property also does not include funds contributed pursuant to IRC §529(b)(1) for college tuition expenses, such as EdVest, again subject to certain limitations. 11 U.S.C. §541(b)(6).

The estate also does not include amounts withheld by employers from wages of the debtor, or received by the employer from the debtor as contributions, to ERISA plans under IRC §414(d), deferred compensation plans under IRC §457, or tax-deferred annuities under IRC §403(b). It also does not include amounts contributed by the employee to health insurance plans regulated by state law. 11 U.S.C. §541(b)(7)(B).

Spendthrift trusts enforceable under Wisconsin law would not constitute property of the estate. 11 U.S.C. §541(c)(2).

The estate also includes all interest of the debtor and the debtor's spouse in community property at the time of the commencement of the case. 11 U.S.C. §541(a)(2). Note, however, that only a debtor may claim property as exempt in the bankruptcy case. 11 U.S.C. §522(b). Significant care should always be exercised if a married debtor is making a single-spouse filing.

D. Exemptions

Under Wisconsin law certain property is exempt from execution. Thus, creditors are unable to obtain this property or to have it liquidated for the satisfaction of their debts. Most, but not all, of such exempt property is described in Chapter 815 of the Wisconsin Statutes.

The Bankruptcy Code provides individual debtors with exemption rights in certain property of the estate. 11 U.S.C. §522(b). Wisconsin debtors in bankruptcy cases are allowed to choose between the state and federal exemptions. These exemptions are claimed by filing Schedule C, which is due within 15 days of the date of the bankruptcy filing. FRBP 1007 and 4003. Debtors may not mix state and federal exemptions, and in a joint filing both husband and wife must claim the same type of exemptions. If they cannot agree, both will have to choose the federal exemptions. 11 U.S.C. §522(b).

Thus, the debtor has a choice of either the federal exemptions found in 11 U.S.C. §522(d), or state exemptions and federal exemptions not found in 11 U.S.C. §522(d). The debtor must be domiciled in a state for 730 days prior to filing in order to elect that state's exemptions. Otherwise, the debtor must use the exemptions for the state of the debtor's domicile during the longest portion of the 180 days preceding the 730-day period. 11 U.S.C. §522(b)(3).

Unless a party in interest objects, the property claimed as exempt is exempt. 11 U.S.C. §522(l). Objections must be filed within 30 days after conclusion of the Section 341 meeting of creditors or within 30 days after filing of any amendment or supplement to the claimed exemptions, whichever is later. FRBP 4003(b). If the time to object is expired, an exemption may not be contested, even if the debtor had no colorable basis for claiming the exemption. *In re Taylor v. Freeland & Kronz*, 112 S. Ct. 1644 (1992). This time limit can be extended for cause, provided the request for extension is filed before the time to object expires. Copies of the objection must be served upon the trustee, the debtor, and the debtor's counsel. FRBP 4003(b). The objection shall be governed by the motion procedures under FRBP 9014. The burden of proof will be upon the objecting party. FRBP 4003(c).

However, such failure to object may still allow the trustee or a creditor to object to the value of the exemption. "Objection to the value of the exemption is different from an objection to the exemption itself…" *In re Page*, 171 BR 349, 352 (Bankr. W.D. Wis. 1994) J. Martin.

Except for the Wisconsin homestead exemption, exemptions generally apply separately to each debtor in a joint case. 11 U.S.C. §522(m). Wis. Stats. §815.18(8). Consider objecting to exemptions claimed for tools of trade by spouses who are not participating in the trade or business. *In re Flake,* 32 BR 360 (Bankr. W.D. Wis. 1983). Be aware, though, that the threshold for such participation may be quite low. *In re Parrish,* 186 BR 246 (Bankr. W.D. Wis. 1995). Judge Martin found that a debtor could exempt farm equipment which she did not use herself, but which her father used on his farm. The debtor resided upon the farm and contributed the equipment as the equivalent of her rent.

A spouse who is not himself or herself an heir may not be entitled to claim an exemption in a bequest to or inheritance by the other spouse. *In re Freund,* 32 BR 622 (Bankr. W.D. Wis. 1983).

Exemptions can only be claimed in "the debtor's interest" in property. Thus, the debtor cannot exempt property that is fully encumbered.

However, the debtor may be able to avoid the fixing of a lien upon an interest in property under various circumstances. Judicial liens may be avoided, other than those that are for domestic support obligations. 11 U.S.C. §522(f)(1)(A).

Also, nonpossessory, nonpurchase-money security interests in certain assets may be avoided, as follows:

(i) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;

(ii) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or

(iii) professionally prescribed health aids for the debtor or a dependent of the debtor.

11 U.S.C. §522(f)(1)(B).

BAPCPA now defines the term "household goods" and specifically excludes certain items, as follows:

(4)(A) Subject to subparagraph (B), for purposes of Paragraph (1)(B), the term household goods means—

(i) clothing
(ii) furniture
(iii) appliances
(iv) 1 radio
(v) 1 television
(vi) 1 VCR
(vii) linens
(viii) china
(ix) crockery
(x) kitchenware
(xi) educational materials and educational equipment primarily for the use of minor dependent children of the debtor
(xii) medical equipment and supplies
(xiii) furniture exclusively for the use of minor children, or elderly or disabled dependents of the debtor
(xiv) personal effects (including the toys and hobby equipment of minor dependent children and wedding rings) of the debtor and the dependents of the debtor
(xv) 1 personal computer and related equipment

(B) The term household goods does not include—

(i) works of art (unless by or of the debtor, or any relative of the debtor)
(ii) electronic entertainment equipment with a fair market value of more than $500 in the aggregate (except 1 television, 1 radio, and 1 VCR)
(iii) items acquired as antiques with a fair market value of more than $500 in the aggregate
(iv) jewelry with a fair market value of more than $500 in the aggregate (except wedding rings)
(v) a computer (except as other wise provided for in this section), motor vehicle (including a tractor or lawn tractor), boat, or a motorized recreational device, conveyance, vehicle, watercraft, or aircraft

Lien avoidance of this type is usually undertaken with respect to high interest rate consumer loans, and is accomplished by notice and a hearing.

E. The Automatic Stay

1. Imposition of the Stay. An automatic stay is imposed by the filing of a bankruptcy petition. 11 U.S.C. §362(a). This stay is one of the most important protections afforded the debtor. Some cases are even filed principally to take advantage of the stay. It prevents harassment of debtors and efforts to disrupt reorganization which might occur if creditors were allowed to pursue separate actions. *Matthews v. Rosene,* 739 F.2d 249 (7th Cir. 1984). It is designed to maintain the status quo, at least for a limited time, by having the bankruptcy court control resolution of actions and claims against the debtor and the debtor's property. The stay is broad. It generally precludes actions against the debtor, property of the debtor and property at the bankruptcy estate. Some examples might be:

- Filing suit against the debtor, whether you are seeking damage, a declaratory judgment or injunctive relief.
- Continuing suit against the debtor, or prosecuting an appeal, whether you are seeking damage, a declaratory judgment or injunctive relief.
- Entering a judgment against the debtor, whether you are seeking damage, a declaratory judgment or injunctive relief.
- Written or verbal demands for payment or offers of settlement.
- Action to recover a fraudulent transfer from the debtor's transferee.

Thus, repossession and foreclosure activities are prohibited as soon as the case is filed. No acts may be taken to recover possession of the property or to enforce the lien. *Nobelman v. American Savings Bank,* 113. S.Ct. 2106 (1993).

The stay goes into effect by operation of law in all cases, whether voluntary or involuntary, immediately upon the filing of the bankruptcy case. It requires no hearing or order from the court and enjoins most actions that affect the debtor or property of the estate. It enjoins any efforts by creditors to commence or to continue any action to recover from the debtor, if the claim arose before the commencement of the case.

The automatic stay not only prohibits taking actions against the debtor or property of the bankruptcy estate, but imposes an affirmative duty to stop violations from occurring. For example, a garnishment action may have been commenced and process served. Upon the filing of the bankruptcy petition, the creditor must take action necessary to halt the garnishment. Another example would be if suit were commenced and summons sent for service prior to the bankruptcy filing. Upon that filing, the plaintiff must contact the process server to ensure process is not served.

The automatic stay is effective even if the creditor has no notice that the case has been filed. Notice becomes an issue only in determining whether a creditor who violates the automatic stay should be sanctioned. An individual injured by a willful violation of the automatic stay "shall recover actual damages, including costs and attorney fees, and in appropriate circumstances, may recover punitive damages." 11 U.S.C. §362(h).

2. Codebtor Stay. The stay generally does not protect guarantors or codebtors of the debtor. Thus, proceedings against a guarantor or codebtor, or against the property of such persons, is not considered an act against the debtor or the property of the estate.

An exception exists, and the stay applies to some degree, to codebtors of debtors, in Chapter 12 and Chapter 13 cases. There, the automatic stay applies to efforts of a creditor to collect all or any part of a consumer debt of the debtor from any codebtor, unless that codebtor became liable on the secured debt in the ordinary course of the codebtor's business. This stay of actions against the

codebtor will apply until the case is closed, dismissed, or converted to one under Chapter 7 or Chapter 11.

This stay of actions against a codebtor can be lifted upon motion of the secured creditor upon any of three grounds, and to the following extents:

1. The codebtor received the consideration for the claim held by the creditor;
2. The plan filed by the debtor proposes not to pay the secured creditor's claim; or
3. The creditor's interest would be irreparably harmed by continuation of the stay.

11 U.S.C. §1201(c) and §1301(c). If neither the debtor nor the codebtor objects within 20 days of the creditor's motion, the codebtor stay will be lifted.

In very limited instances, bankruptcy courts have enjoined actions against guarantors or codebtors where those actions would have adversely affected the bankruptcy estate or interfered with a reorganization. *In re Fernstrom Storage & Van Co*., 938 F.2d 731 (7th Cir. 1991). These injunctions are issued under the court's equitable powers. 11 U.S.C. §105(a).

Individual partners will not be protected by the automatic stay effected by the filing of a bankruptcy by the partnership. *In re Dreske*, 25 BR 268 (Bk WI 1982). This is because a partnership is recognized under bankruptcy law as a separate and distinct entity from the partners. The only protection available to the partners might be that afforded by the court under 11 U.S.C. §105.

3. Setoff. Secured creditors often are both a creditor of, and obligated to, the debtor. A bank or other financial institution may be a creditor by having made a loan to the debtor, but may also have possession of funds belonging to the debtor in the debtor's checking or savings account. Most states, including Wisconsin, recognize a right of setoff in favor of such a creditor. However, the automatic stay prohibits the creditor from setting off mutual debts which arose before the case was filed. 11 U.S.C. §362(a)(7). Any setoff by the creditor after the filing of the bankruptcy case could subject the creditor to sanctions for violation of the automatic stay. In addition, the bankruptcy trustee or the debtor in possession may have the power to recover any amounts so set off.

The best approach for creditor institutions in such situations is swiftly to freeze the debtor's account and file a motion for relief from the automatic stay to permit setoff of that account. The refusal by the financial institution to pay over to the debtor the funds in the debtor's account, provided that refusal is only temporary while the lender seeks relief under 11 U.S.C. §362, will not constitute a setoff under 11 U.S.C. §362(a)(7). The refusal to pay must not be permanent or absolute. Such an administrative hold has been held not to violate 11 U.S.C. §362. *Citizens Bank of Maryland v. Strumpf*, 116 S.Ct. 286 (1995).

4. Exceptions to the Stay. Not all creditor activities are stayed. 11 U.S.C. §362(b) sets forth at least 28 separate exceptions. A few common exceptions are as follows:

a. The commencement or continuation of actions by governmental units to enforce police and regulatory powers. 11 U.S.C. §362(b)(4). This section would, for example, entitle a local health department to order the debtor to cure any defect in the debtor's rental properties. This section also exempts from the automatic stay such administrative procedures as worker's compensation adjudications.

b. Income tax refunds may be set off by the appropriate governmental unit. §362(b)(26).

c. Governmental units may conduct tax audits, issue notices of tax deficiency, demand tax returns, and make tax assessments. 11 U.S.C. §362(b)(8).

d. If the debtor is a tenant under a lease of nonresidential real property, and if the lease has terminated by expiration of the stated term of the lease before commencement of the case, or during the case, the lessor may proceed to obtain possession of the property. 11 U.S.C. §362(b)(10). Thus, landlords in nonresidential leases may commence or continue eviction actions under these circumstances.

e. The holder of a negotiable instrument, such as a check, may proceed with presentment and notice of dishonor of that instrument. 11 U.S.C. §362(b)(11). A negotiable instrument may be presented for payment. *In re Roete,* 936 F.2d 963 (7th Cir. 1991). A debt may be accelerated after the bankruptcy filing, since acceleration does not affect the debtor's rights with respect to the claim. *Matter of LHD Realty Corp.,* 726 F.2d 327 (7th Cir. 1984).

The automatic stay does not toll or suspend the running of a redemption period. That time continues to run even after the case is filed. *Johnson v. First National Bank of Monte Video,* Minn., 719 F.2d 270 (8th Cir. 1983), cert. denied, 465 U.S. 1012 (1984). The debtor may be able, however, to get up to a 60-day extension of the redemption period, if the bankruptcy filing is made before the redemption period has expired. In that instance, the redemption period will expire when originally scheduled or 60 days after the bankruptcy filing, whichever is later. 11 U.S.C. §108(b). Even if the redemption period has run and a foreclosure sale has been held, a secured creditor must obtain relief from the stay before proceeding with the hearing for confirmation of sale. *United States v. Molitor,* 91-C-308-C (W.D. Wis. 1992).

f. Exception for Domestic Support Obligations. BAPCPA added a new definition at 11 U.S.C. §101(14)(A) for the term domestic support obligation (DSO):

> The term "domestic support obligation" means a debt that accrues before, on, or after the date of the order for relief in a case under this title, including interest that accrues on that debt as provide under applicable nonbankruptcy law notwithstanding any other provision of this title, that is—
>
> (A) owed to or recoverable by—
>
> (i) a spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative; or
>
> (ii) a governmental unit;
>
> (B) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of such spouse, former spouse, or child of the debtor or such child's parent, without regard to whether such debt Is expressly s designated;
>
> (C) established or subject to establishment before, on, or after the date of the order for relief in a case under this title, by reason of applicable provisions of—
>
> (i) a separation agreement, divorce decree, or property settlement agreement;
>
> (ii) an order of a court of record; or
>
> (iii) a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and

(D) not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative for the purpose of collecting the debt.

Formerly, the automatic stay applied to divorce and family proceedings generally. It excepted commencement or continuation of an action or proceeding to establish paternity, or to establish or modify an order for alimony, maintenance, or support. An exception also existed for the collection of alimony, maintenance, or support from property that was not property of the estate.

Under BAPCPA, it appears that almost any action related to divorce and custody is excepted from the automatic stay, other than property division when the property to be divided is property of the estate. 11 U.S.C. §362(b) now provides in part that:

The filing of a petition . . . does not operate as a stay—

. . . .

(2) under subsection (a)—

(A) of the commencement or continuation of a civil action or proceeding—

(i) for the establishment of paternity;

(ii) for the establishment or modification of an order for domestic support obligations;

(iii) concerning child custody or visitation;

(iv) for the dissolution of a marriage, except to the extent that such proceeding seeks to determine the division of property that is property of the estate; or

(v) regarding domestic violence;

(B) of the collection of a domestic support obligation from property that is not property of the estate;

(C) with respect to the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial or administrative order or a statute;

(D) of the withholding, suspension, or restriction of a driver's license, a professional or occupational license, or a recreational license, under state law, as specified in section 466(a)(16) of the Social Security Act;

(E) of the reporting of overdue support owed by a parent to any consumer reporting agency as specified in section 466(a)(7) of the Social Security Act;

(F) of the interception of a tax refund, as specified in sections 464 and 466(a)(3) of the Social Security Act or under an analogous state law; or

(G) of the enforcement of a medical obligation, as specified under title IV of the Social Security Act.

5. Duration of the Stay. The automatic stay applies to any act against property of the estate until that property is no longer property of the estate. In a Chapter 7 no-asset case, this is usually accomplished by the trustee filing a no-asset report. The no-asset report is equivalent to an abandonment of the trustee's interest in the property of the estate. *In re John W. Alt, Jr.* (Bk W.D. WI).

In any case, exempt property will revest in the debtor. Thus, if no objection is made to the claimed exemption within 30 days after the meeting of creditors, the property will be deemed exempt and become property of the debtor rather than property of the estate.

A third method by which property may cease to be property of the estate is by abandonment pursuant to 11 U.S.C. §554(b). Such abandonment requires a motion and demonstration that the property sought to be abandoned is burdensome to the estate or is of inconsequential value and no benefit to the estate. Notice must be provided to all parties in interest. If no objection is made, the court will generally grant the order for abandonment without hearing.

Even when collateral is no longer property of the estate, the stay may remain in effect pursuant to 11 U.S.C. §362(a)(5). That section does not refer to property of the estate, but to property of the debtor. The stay of any act, other than one against property of the estate, continues until the earliest of:

- The time the case is closed;
- The time the case is dismissed; or
- The time a discharge is granted or denied in a case under Chapters 11, 12, or 13, or under Chapter 7 if the debtor is an individual. 11 U.S.C. §362(c).

Thus, even if the property has been abandoned, the foreclosing party must await the dismissal of the case or the discharge of the debtor before proceeding with foreclosure activity.

F. Discharge/Dischargeability

1. Denial of Discharge. In most cases, the goal of the debtor is to obtain a discharge. That discharge may be denied because of the debtor's status or because of wrongful acts by the debtor.

Only an individual may be entitled to a discharge under Chapter 7. No other entity will receive a discharge under that chapter. 11 U.S.C. §727(a)(1). Even an individual may not receive a Chapter 7 discharge if that individual has previously received a Chapter 7 or Chapter 11 discharge within eight years. §727(a)(8).

A similar but shorter six-year bar also applies in a limited manner to Chapter 13 cases. A debtor who has received a discharge in a Chapter 13 case commenced within six years of the present Chapter 7 filing will not receive a Chapter 7 discharge, unless the payments under the Chapter 13 plan in that earlier case totaled at least:

- 100% of the allowed unsecured claims in that case; or
- 70% of such claims and the plan was proposed by the debtor in good faith and was the debtor's best effort. §727(a)(9).

Nearly all of the other grounds for objecting to discharge involve wrongful acts on the part of the debtor. Those categories of acts are as follows:

a. Debtor's intentional destruction or concealment of property. Discharge may be denied if the debtor transfers, removes, destroys, mutilates or conceals property of the debtor within one year prior to the filing of the case, or property of the estate after the filing. These acts by the debtor must be with intent to hinder, delay or defraud a creditor or the trustee. 11 U.S.C. §727(a)(2). Intent may be shown by the "badges of fraud." For example, a presumption of such intent may exist if the debtor makes a gift or transfer on the eve of bankruptcy. *Matter of Ramos*, 8 B.R. 490 (Bankr. W.D. Wis. 1981).

The one-year period prior to the filing of the case may be enlarged in the event of concealment. In such instance, the concealment is continuing, and each day of concealment would constitute another day for determining the one-year period. *Matter of Kauffman*, 675 F.2d 127 (7th Cir. 1981). *Matter of Ries*, 22 B.R. 343 (Bankr. W.D. Wis. 1982).

b. Concealment or destruction of financial or business books and records. Discharge may be denied if the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve recording information from which the debtor's financial condition and business transactions might be ascertained. 11 U.S.C. §727(a)(3). This does not mean that debtors must maintain and retain all business papers. Discharge may still be granted if the act or failure to act was justified under the circumstances of the case. *Id*. Intent is not a necessary element for denial of discharge on these grounds. *Matter of Juzniak*, 89 F.3d 424 (7th Cir. 1996); *In re Scott*, 172 F.3d 959 (7th Cir. 1999).

c. False oaths or withholding information. Another ground for denying discharge involves commission of bankruptcy crimes. These wrongful acts include the debtor knowingly and fraudulently, in connection with the bankruptcy case:

- Making a false oath or account
- Presenting or using a false claim
- Giving, offering, receiving or attempting to obtain money, property or advantage, or a promise of same, for acting or forbearing to act
- Withholding from the trustee any recorded information relating to the debtor's property or financial affairs.

11 U.S.C. §727(a)(4).

Although these actions are commonly referred to as "bankruptcy crimes," the standard of proof for the purpose of objecting to discharge is a preponderance of the evidence, not the criminal standard of proof beyond a reasonable doubt. *In re Scott*, 172 F.3d 959 (7th Cir. 1999). The party objecting to discharge has the burden of proof. FRBP 4005; *In re Thirtyacre*, 36 F.3d 697 (7th Cir. 1994).

d. Failure to explain loss or deficiency of assets. Discharge may be denied if the debtor fails satisfactorily to explain any loss of assets or any deficiency of assets. 11 U.S.C. §727(a)(5). Vague and evasive explanations will not be sufficient. *In re D'Agnese*, 86 F.3d 732 (7th Cir. 1996).

e. Refusal to obey a lawful order of the bankruptcy court. Discharge may be denied if the debtor refuses to obey a lawful order of the bankruptcy court, other than an order to respond to a material question or to testify. Discharge may be denied if the debtor refuses to testify after having been granted immunity, or after improperly invoking the constitutional privilege against self incrimination. Discharge will only be denied in these instances. 11 U.S.C. §727(a)(6).

f. Wrongful acts in connection with another bankruptcy involving an insider. If within one year before filing of the bankruptcy case, or during the case itself, the debtor commits any of the acts described above in connection with another bankruptcy case concerning an insider, the discharge may be denied. 11 U.S.C. §727(a)(7). Any of these acts will be sufficient. *Matter of Krehl*, 86 F.3d 737 (7th Cir. 1996).

An objection to discharge requires an adversary proceeding, and is commenced by the filing of a complaint and the issuance of a summons. FRBP 7001(4). In a Chapter 7 case, the complaint must be filed within 60 days following the first date set for the meeting of creditors. In Chapter 11, the complaint must be filed before the first date set for the confirmation hearing. FRBP 4004(a).

2. Revocation of Discharge. Once a Chapter 7 discharge is granted, it may be revoked only upon one of three statutory grounds. The first is that the discharge was obtained through fraud on the part of the debtor and the party objecting did not know of the fraud until after the discharge was granted. 11 U.S.C. §727(d)(1).

The second available ground might be that the debtor acquired or became entitled to property of the estate and knowingly and fraudulently failed to report that acquisition or entitlement, or to deliver or surrender the property, to the trustee. 11 U.S.C. §727(d)(2).

The third ground incorporates that shown above, being the debtor's refusal to obey a lawful order of the court. 11 U.S.C. §727(d)(3).

The trustee, a creditor, or the United States trustee, may request revocation of discharge. The request must be made within one year after the granting of the discharge if the grounds are newly discovered fraud. If either of the other two grounds are the basis for the revocation request, the request must be made before the later of one year after the discharge is granted or the time the case is closed. 11 U.S.C. §727(e).

As with an objection to discharge, a request for revocation must be made by adversary proceeding. FRBP 7001(4).

3. Contesting Dischargeability. Objections to discharge are relatively rare, at least in comparison to objections to the dischargeability of a particular claim. Certain debts are excepted from discharge, as set forth at 11 U.S.C. §523(a). These exceptions to discharge have been enlarged over the years by Congress, so that there are now 18 specific subsections. Those of most relevance to creditors are the following:

a. Debts incurred by fraud. 11 U.S.C. §523(a)(2)

False representations or fraud. A Chapter 7 debtor is not discharged from any debt for money, property, services, or for an extension, renewal or refinancing of credit, if such consideration was acquired by false pretenses, a false representation, or actual fraud. This exception does not apply to a statement respecting the debtor's or an insider's financial condition. The debtor must have known the representation was false, or must have acted with such reckless disregard as to constitute willfulness. *Matter of Sheridan,* 57 F.3d 627 (7th Cir. 1995). A creditor must show justifiable reliance on the false representations. Justifiable reliance does not necessarily mean reasonable reliance. Thus, a creditor need not show it investigated the debtor's representations before relying upon them. *Field v. Mans*, 116 S. Ct. 437 (1995).

Reliance may not be necessary at all if the fraud takes a form other than misrepresentation. See *McClellan v. Bobbie Cantrell*, 217 F.3d 890 (7th Cir. 2000).

False financial statements. If the debtor obtained the above-described consideration by use of a false financial statement, the creditor may be successful in objecting to dischargeability. The statement must be in writing, must be materially false, and must be with respect to the debtor's or an insider's financial condition. The creditor must have reasonably relied upon the false statement. See *In re Morris*, 223 F.3d 548 (7th Cir. 2000). (No reasonable reliance by creditor which reached settlement with debtor without investigation and with prior knowledge of alleged dishonesty.) The creditor must also show the debtor caused the statement to be made or published it with intent to deceive. Intent to deceive can be inferred from false statements. *In re Green*, 241 B.R. 550 (Bankr. N.D. Ill. 1999).

Consumer debts owed to a single creditor and aggregating more than $500 for luxury goods or services, incurred within 90 days of the bankruptcy filing, are presumed to be nondischargeable. Similarly, cash advances aggregating more than $750 are presumed to be nondischargeable if obtained within 70 days before the filing.

b. Debts not listed or scheduled. 11 U.S.C. §523(a)(3). A debt which is neither listed nor scheduled in time to permit the creditor to file a timely proof of claim will not be discharged, unless the creditor had actual knowledge or notice of the case in time for such a timely filing. Because most cases are no-asset cases, with no distributions to creditors, this limitation does not often arise.

More often, a creditor may object to dischargeability of its debt because the debt was not listed, and was a debt obtained by false pretenses, by fraud in a fiduciary capacity, or for willful and malicious injury by the debtor or property division debts arising from a divorce. These types of objections to dischargeability, under §523(a)(2), (4), (6), and (15) apply only if the creditor makes a timely request for a determination of dischargeability. Such a determination must be made by adversary proceeding under FRBP 7001, with the complaint filed within 60 days of the first date set forth the meeting of creditors. FRBP 4007(a). If a creditor does not have notice of the case, it will not have the ability to file a complaint to determine dischargeability. Thus, the debt will not be discharged.

However, a creditor without grounds to object to dischargeability will in a no-asset case find its debt discharged, even if that creditor was neither listed nor scheduled by the debtor. *In re Guseck*, 310 B.R. 400 (Bankr. E.D. Wis. 2004). The rationale is that even had the creditor known of the case, there were no assets available for distribution. In no-asset cases, no bar date is set, so the creditor never lost an opportunity to file a proof of claim.

c. Debts for fiduciary fraud, embezzlement or theft. Debts incurred by embezzlement or larceny are not dischargeable, nor are debts incurred by fraud or defalcation while the debtor is acting in a fiduciary capacity. 11 U.S.C. §523(a)(4). A creditor objecting to dischargeability upon embezzlement or larceny grounds must prove intentional fraud, while defalcation by a fiduciary requires less proof. *In re Gumieny,* 8 B.R. 602 (Bankr. Wis. 1981). A common example of such a debt is a theft by contractor claim against the contractor who diverted construction funds to purposes other than paying subcontractors or material suppliers on that project. *Matter of Thomas*, 729 F.2d 502 (7th Cir. 1984). Another example would be failure of a debtor to turn over lottery ticket sale proceeds. *Matter of Marchiando*, 13 F.3d 1111 (7th Cir. 1994).

Whether or not the debtor is a fiduciary for these purposes will be a question of federal law. *In re Loken*, 32 B.R. 205 (Bankr. W.D. Wis. 1983).

d. Willful and malicious injury to persons or property. 11 U.S.C. §523(a)(6). This objection would include conversion of collateral by the debtor. The conduct must be deliberate and intentional. *In re Chambers*, 23 B.R. 206 (Bankr. W.D. Wis. 1982). The amount of the nondischargeable debt will be limited to the value of the property converted.

e. Previously nondischarged debts. Debts which were not discharged in an earlier bankruptcy case on any grounds other than the debtor having been granted a discharge within the previous six years will not be discharged in this later case by the debtor.

The creditor objecting to dischargeability has the burden of proof. *In re Bogstad*, 779 F.3d 370 (7th Cir. 1985). In most cases, each element must be proven by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279 (1991).

f. Alimony, maintenance, and support and other obligations arising from a divorce or separation. 11 U.S.C. (a)(5) and (a)(15) deal with these exceptions. Debts for alimony, maintenance, or support are known as domestic support obligations (DSO) and are not dischargeable in bankruptcy. DSOs may be owed to or recoverable by a spouse, former spouse, or child, or by a governmental unit. 11 U.S.C. §523(a)(5). The bankruptcy court is not bound by the divorce court's characterization, although that will likely be an important factor. *Matter of Chambers,* 36 B.R. 42 (Bankr. W.D. Wis. 1984).

Other obligations arising from a divorce or separation may or may not be dischargeable, depending upon the bankruptcy chapter involved and other factors. Such debts are dischargeable in a Chapter 13 case but could be the subject of an adversary proceeding under the other chapters. The adversary proceeding must be filed in the bankruptcy court within the time fixed for filing such actions, usually within 60 days after the first date for the meeting of creditors. B.R. 4007(c).

The bankruptcy court and the divorce court have concurrent jurisdiction to determine whether a debt constitutes a DSO. Only the bankruptcy court has jurisdiction to determine dischargeability of property division debts under §523(a)(15). Chapter 13 debtors can discharge the type of obligations described in 11 U.S.C. §523.

The creditor objecting to dischargeability has the burden of proof. *In re Bogstad*, 779 F.3d 370 (7th Cir. 1985). *Matter of VandeZande,* 22 B.R. 328 (Bankr. W.D. Wis. 1982). In most cases, each element must be proven by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279 (1991).

The doctrine of issue preclusion may collaterally stop the debtors from contesting the objection to discharge. For example, in *In Re Cole*, 234 B.R. 417 there was a prior determination that the debtor committed battery. Because the charge was defined as "intentionally causing bodily harm to another," Judge Martin granted summary judgment to the state on claims of nondischargeability under 11 U.S.C. §523(a)(6).