

BANKRUPTCY BASICS OVERVIEW

By Wesley Parks

I. Bankruptcy Overview

In 1842, Abraham Lincoln described the procedure for filing a bankruptcy to his friend and colleague C.B. Shelledy, also an attorney, as follows:

Thinking it may aid you a little, I send you one of our blank forms of Petitions. It, you will see, is framed to be sworn to before the Federal court clerk, and, in your cases, will have to be so far changed, as to be sworn to before the clerk of your circuit court; and his certificate must be accompanied with his official seal. The schedules too, must be attended to. Be sure that they contain the creditors names, their residences, the amounts due each, the debtors names, their residences, and the amounts they owe, also all property and where located. Also be sure that the schedules are signed by the applicants as well as the Petition.¹

The process described by Abraham Lincoln in 1842 still holds true today. Bankruptcy is governed by federal law, 11 U.S.C. § 101, *et seq.* (the “Bankruptcy Code”).² To commence a bankruptcy on behalf of a debtor, debtors must file a petition and schedules, identify themselves and all their property, debts, and creditors. Upon filing of the petition, a bankruptcy estate is formed that includes all of the debtor’s property, to the extent that the property is not exempt. The bankruptcy estate is administered by a trustee assigned to the estate. The job of the trustee is to work for the benefit of the creditors, and the judge functions to balance the rights of creditors and debtors during a bankruptcy proceeding. Part I of this writing will first provide an overview of bankruptcy and the most common consumer debtor bankruptcies filed: chapter 7 and chapter 13. A general overview of a chapter 11 business reorganization is discussed, followed by a discussion of the automatic stay. This part ends with a discussion of non-dischargeable debts. Part II discusses the players and stakeholders in bankruptcy.

A. Consumer Bankruptcy

¹ John M. Bates, *The Practitioner and the Bankruptcy Process*, 15 Vanderbilt L.R. 2 (1961) (citing Letter from Abraham Lincoln to C.B. Shelledy).

² It should be noted that bankruptcy courts are required to apply state laws to resolve certain issues, such as state exemption law when applicable or fraudulent conveyance laws.

When a debt-ridden client schedules a consult with a bankruptcy attorney, the attorney must make an initial determination as to whether to liquidate or reorganize.³ A liquidation bankruptcy, sometimes called a “straight bankruptcy,” is provided for in chapter 7 of the Bankruptcy Code. A reorganization, previously known as a “rehabilitation,” is provided for in chapter 13 of the Bankruptcy Code. Both of these chapters can provide a fresh start to debtors and relieve them from overbearing debt burdens. Each chapter, however, has different requirements for debtors. The following discussion is meant to give the reader a general overview of common chapters of bankruptcy that may come up in mediation.

(1) Chapter 7

Chapter 7 is for debtors who are experiencing financial difficulty and cannot pay their creditors. In a chapter 7, the debtor’s income must be at or below the median income of similar household sizes in the locale in which the debtor resides, in order to avoid a presumption of bankruptcy abuse. The debtor must pass a “disposable income test” and a “means test” that determines whether or not the debtor has the means to pay creditors.⁴ If these two threshold tests—the median income and means—are passed, the debtor qualifies for a chapter 7 liquidation. Upon filing for bankruptcy, the debtor’s property becomes property of the bankruptcy estate.⁵ To the extent that the debtors’ property is exempt as set forth in applicable state or federal exemption law, the property remains with the debtor.⁶ The trustee liquidates non-exempt property in a chapter 7, and, after administrative fees are subtracted, distributes the proceeds to the creditors.⁷ After the expiration of the creditor objection period, the debtor receives a discharge of debts that are dischargeable under the Bankruptcy Code and receives a “fresh start.”⁸ The typical chapter 7 lasts from four to six months start to finish.

(2) Chapter 13

Chapter 13 is for debtors who are struggling with paying their debts, who have regular incomes, and who have the ability to pay their creditors some or all of the debt owed in installments over three to five years. In a chapter 13, debtors must propose a chapter 13 repayment plan that the court must approve.⁹ Debtors under this chapter may keep property that would otherwise have been liquidated in a chapter 7; however, any property that would have been liquidated in a chapter

³ Bates, *supra* n. 1 at 2.

⁴ 11 U.S.C. § 707(b)(2).

⁵ 11 U.S.C. § 541. This section of the Bankruptcy Code defines what is part of the bankruptcy estate in § 541(a), and what is not part of the bankruptcy estate in § 541(b)

⁶ 11 U.S.C. § 522. Debtors may exempt certain property from the estate as provided in § 522(d). The exemptions provided in § 522(d) are referred to as the “federal exemptions”; however, state law exemptions typically apply when a debtor has lived in a location for two consecutive years. *See* § 522(b)(3)(A).

⁷ 11 U.S.C. § 726.

⁸ 11 U.S.C. § 727.

⁹ 11 U.S.C. § 1322.

7 must be paid to creditors through the chapter 13 plan.¹⁰ After any and all objections to the plan are resolved, the plan is confirmed by the court.¹¹ If the debtor makes all payments pursuant to the terms of the plan, the debtor receives a discharge of any debts that remain unpaid at the completion of the repayment plan, so long as those debts are dischargeable.¹²

A. Business Bankruptcy: Chapter 11

The central goal of a chapter 11 bankruptcy is to enable a business (and individuals in some cases) to reorganize so that it may continue to operate during the bankruptcy.¹³ A chapter 11 allows the business to restructure finances so that it may continue to provide employment for its workers, pay creditors, provide returns to shareholder, and keep the business afloat.¹⁴ More broadly, a chapter 11 seeks to “maximize the value of the debtor’s business to society by preserving the private and social components of its going concern when there is a good probability for success of reorganization.”¹⁵ In a chapter 11, there is a tension between debtors and creditors in that debtors favor a delay in the bankruptcy proceeding “as long as possible in an effort to wait for the business to increase in value and succeed,”¹⁶ whereas, creditors want to reduce the length of the proceeding so that it may foreclose on its collateral or realize profits from its liquidation.¹⁷ Chapter 11 bankruptcies are notoriously long and drawn-out, and mediation should be used more often in these cases “as a means for shortening the time companies spend in chapter 11 reorganizations.”¹⁸ Bankruptcy courts have recently begun to appoint mediators to serve as facilitators for plan negotiations in chapter 11 bankruptcies.¹⁹ The above are the most common chapters that employ bankruptcy mediation. Below, we will continue our overview of bankruptcy with a discussion of the automatic stay.

B. The Automatic Stay

The automatic stay provided in 11 U.S.C. § 362 is one of the fundamental debtor protections under the Bankruptcy Code, and it provides debtors with immediate sweeping relief

¹⁰ 11 U.S.C. § 1325(a)(4). This is often referred to as the “best interest of the creditors” test. It provides that the unsecured nonpriority creditors in a chapter 13 must also get as much as they would have received in a chapter 7 liquidation.

¹¹ 11 U.S.C. § 1325(a).

¹² 11 U.S.C. § 1328; *See also* 11 U.S.C. § 523. The section of the Bankruptcy Code contains a list of debts that are excepted from discharge, including but not limited to, child support and maintenance § 523(a)(5), (15), student loan debt § 523(a)(8), and debts incurred as a result of fraud or other wrongful acts § 523(a)(2),(4), and (6), discussed in more detail *infra* in § I(E).

¹³ Steven R. Wirth; *Joseph P. Mitchell, A Uniform Structural Basis for Nationwide Authorization of Bankruptcy Court-Annexed Mediation*, 6 Am. Bankr. Inst. L. Rev. 213, 226-227 (1998).

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.* “The least favored outcome for the secured creditor is a confirmation of the plan because it only assures that they will be paid some time [*sic*] in the future.”

¹⁸ *Id.*

¹⁹ Jacob A. Esher, *Alternative Dispute Resolution in U.S. Bankruptcy Practice*, 4 S. New Eng. Roundtable Symp. L.J. 76, 87 (2009).

from their debts upon the moment of filing for bankruptcy. The automatic stay is a very broad injunction that affects most other areas of the law. “The stay is the heart of bankruptcy and designed to give debtors relief from the financial pressure that drove them into bankruptcy.”²⁰ It prohibits the commencement or continuance of any collection efforts involving debts arising prior to the filing of the bankruptcy.²¹ The automatic stay halts foreclosures, garnishments, levies, and creditor harassment.²² From a judicial perspective, the stay provides for economy and efficiency in handling the debtor’s affairs in a bankruptcy.

[The automatic stay is intended] to prevent a chaotic and uncontrolled scramble for the debtor’s assets in a variety of uncoordinated proceedings in different courts. The stay insures [*sic*] that the debtor’s affairs will be centralized, initially, in a single forum in order to prevent conflicting judgments from different courts and in order to harmonize all of the creditors’ interests with one another.²³

“[T]he automatic stay deprives state courts of jurisdiction over the debtor and its property unless the bankruptcy court lifts or modifies the stay.”²⁴ In order for state court actions to continue, relief from the stay must be obtained from the bankruptcy court by filing a motion pursuant to 11 U.S.C. § 362(d).

A violation of the automatic stay may occur whether or not the creditor or the creditor’s agent has knowledge of the debtor’s bankruptcy.²⁵ The Bankruptcy Code provides that when there is a “willful violation of a stay [the debtor] shall recover actual damages, including costs and attorneys’ fees, and, in appropriate circumstances, may recover punitive damages.”²⁶ However, even if there is no “willful violation,” any agreement reached in a mediation conducted in violation of the stay would be void. “Any action taken in violation of the stay is void and without effect.”²⁷ Thus, judicial and administrative actions taken against the debtor, including court ordered mediation resulting mediated agreements, entered into in violation of the stay are void.

Certain debt collection efforts are not violations of the automatic stay. For example, a bankruptcy filing does not stay criminal proceedings or domestic matters to establish paternity, establish, modify, or enforce child support or spousal maintenance, or to establish or modify

²⁰ Mark S. Zuckerberg, *The Heart of Bankruptcy: The Automatic Stay*, 54 Res Gestae 24 (2011).

²¹ 11 U.S.C. 362(a)(1)-(8).

²² Zuckerberg, *supra* n. 13 at 24.

²³ *Fidelity Mortgage Investors v. Camelia Builders, Inc.*, 550 F.2d 47, 55 (2nd Cir. 1976), *cert. denied*, 429 U.S. 1093, 97 S.Ct. 1107, 51 L.Ed.2d 540 (1977).

²⁴ *Chunn v. Chunn*, 929 S.W.2d 490, 492 (Tex. App. 1996). “The United States Supreme Court and the Texas Supreme Court have both held that judicial actions taken against the debtor in violation of an automatic stay are void, not voidable.” *Id.*

²⁵ Zuckerberg, *supra* n. 20 at 24.

²⁶ 11 U.S.C. § 362(k)(1).

²⁷ *Franklin Sav. Ass’n v. Office of Thrift Supervision*, 31 F.3d 1020, 1022 (10th Cir. 1994).

parenting time. The filing of a bankruptcy does not stay dissolution of marriage action related to the aforementioned domestic matters; however, the automatic stay will impede the domestic court from entering orders related to property division unless relief from stay is obtained. Although state courts may continue most domestic actions from the automatic stay, many courts stay domestic matters until a relief from the automatic stay is obtained, in order to avoid any possible violations.²⁸ Because property division and support are so intertwined in dissolution of action matters, the most prudent course of action would be to get relief from stay if a bankruptcy is filed during the pendency of such actions, despite some of the exceptions provide in the Bankruptcy Code. The reason some debts are not subject to the automatic stay is because they are not dischargeable in bankruptcy, which we will turn our attention to next.

C. Non-Dischargeable Debts

Attorneys should have knowledge of debts that are not dischargeable in a bankruptcy. The “fresh start” provided in the Bankruptcy Code “limits the opportunity for a completely unencumbered new beginning to the ‘honest but unfortunate debtor.’”²⁹ In addition, certain categories of debts, such as those for domestic support, educational loans, restitution, and taxes are not dischargeable. “Congress evidently concluded that the creditors’ interest in recovering full payment of debts in these categories outweighed the debtors’ interest in a complete fresh start.”³⁰ A brief review of the most common non-dischargeable debts follows:

(1) Domestic Support Obligations

Whether a debt related to a divorce settlement is dischargeable is often a subject of bankruptcy disputes. In general, debts arising from a Domestic Support Obligation (“DSO”) are not dischargeable in bankruptcy. A DSO includes child support, spousal maintenance, or any other obligation that is “in the nature of alimony, maintenance, or support” without regard as to whether such debt is expressly designated as such.³¹ 11 U.S.C. §§ 523(a)(5) and (a)(15) “are companion sections that address the dischargeability of a debtor’s financial obligations pursuant to a divorce or separation agreement.”³² “Non-dischargeable debts under § 523(a)(5) are generally referred to as being in the nature of alimony or support, while debts under § 523(a)(15) are referred to as being in the nature of a property division.”³³ Thus, a chapter 13 discharge does not except debts incurred from the property division in a divorce, unless the debt is shown to be “in the nature of alimony, maintenance, or support.”³⁴

²⁸ This assertion is made from personal experience of the authors, who have both practiced family law and who have both had the experience of dissolution proceedings being stayed until relief is obtained from the bankruptcy court.

²⁹ *Grogan v. Garner*, 498 U.S. 279, 286-287 (1991).

³⁰ *Id.*

³¹ 11 U.S.C. § 101(14A); 11 U.S.C. § 523(a)(5), (a)(15). In general, debts incurred as a result of a property division are non-dischargeable in a chapter 7, but may be discharged in a chapter 13 if not in the nature of support.

³² *In re Lobato*, No. ADV 11-1309 EEB, 2011 WL 5974674, at *2 (Bankr. D. Colo. Nov. 29, 2011).

³³ *Id.*

³⁴ 11 U.S.C. § 101(14A).

When determining whether a property division from a divorce is “in the nature of alimony, maintenance, or support,” the bankruptcy court will look at the parties’ intent at the time of the divorce. Evidence of intent that the property division is “in the nature of alimony, maintenance, or support,” includes but is not limited to: language in the separation agreement that property is divided in lieu of maintenance; language in the separation agreement demonstrating financial need; whether maintenance has been waived; and whether the property division was necessary for the health and wellbeing of the children.³⁵ In a chapter 13, domestic support obligations must be paid in full before a chapter 13 plan may be confirmed and are considered first priority debts.³⁶ In addition to DSOs, there are other debts that are non-dischargeable in bankruptcy as discussed below.

(2) Debts Related to Dishonest/Wrongful Conduct

As part of bankruptcy’s public policy of providing a “fresh start” to the honest and unfortunate debtor, dishonest or wrongful acts that result in debt are not dischargeable in bankruptcy. In other words, the Bankruptcy Code exempts from discharge such debts incurred as a result of dishonest or wrongful conduct. For example, debts incurred as a result of fraud, misrepresentation, willful and malicious injury, breach of fiduciary duty, conversion, embezzlement, and larceny are non-dischargeable.³⁷ Debts incurred as a result of a criminal act, such as drunk driving or other forms of criminal restitution, are also not dischargeable.³⁸

(3) Other Non-Dischargeable Debts

Other non-dischargeable debts include debts incurred as a result of government fines, certain priority taxes, luxury goods and cash advances taken within 90 days before filing, student loans unless undue hardship can be proven, and debts not listed in the bankruptcy petition and schedules.³⁹ Now that we have completed a basic overview of bankruptcy, we will turn our attention to the players and stakeholders in bankruptcy.

³⁵ *In re Biggs*, 907 F.2d 503 (5th Cir. 1990) (even if not entitled to maintenance under state law the bankruptcy courts can still find the obligation non-dischargeable); *Richardson v. Edwards*, 127 F.3d 97 (D.C. Cir. 1997) (obligation to pay mortgage payment considered dischargeable); *Sylvester v. Sylvester*, 865 F.2d 1164 (10th Cir. 1989) (holding that even though maintenance was forever waived the support was meant to be in the nature of support); *In re Yeates*, 807 F.2d 874 (10th Cir.1986) (income and needs at time of dissolution is most persuasive); *In re Lobato* 2011 WL 5974674 (Bankr. D. Colo. 2011) (labels don’t bind the bankruptcy court); *In re Catron*, 164 B.R. 912 (E.D. Va. 1994)(can’t agree in advance of non-dischargeability, but it helps to determine intent); *In re an Nice*, 2007 WL 2178069 (Bankr. D. Mont. 2007) (where child of debtor prevailed in action against father for post-secondary education).

³⁶ 11 U.S.C. § 507(a)(1); 11 U.S.C. § 1322(a)(2).

³⁷ 11 U.S.C. § 523(a)(2), (a)(4), (a)(6).

³⁸ Robertson B. Cohen, *Top Ten Topics in Bankruptcy for the Non-Bankruptcy Attorney*, 37 Colo. Law. 19, 23-24 (2008).

³⁹ *Id.*

II. Understanding the Players and Stakeholders in Bankruptcy

The key players in a bankruptcy matter are comprised of the judge, the trustees, the debtor, the creditors of the debtor, and other parties in interest. Each will be discussed in more detail below.

(1) The Bankruptcy Judge

The district courts of the United States have “original and exclusive jurisdiction of all cases under [the Bankruptcy Code].”⁴⁰ The district courts may refer all Bankruptcy Code proceedings to bankruptcy judges in their district. Bankruptcy judges in each district are appointed to 14-year terms by the courts of appeals in the respective circuits to which the district courts are located.⁴¹ Bankruptcy judges are appointed under Article I of the United States Constitution, and they do not receive lifetime tenure as those judges appointed under Article III. As such, bankruptcy judges only have jurisdiction to hear cases that are considered “core proceedings” under the Bankruptcy Code. Core proceedings are matters that are “related to” bankruptcy proceedings, but do not include counterclaims based on state tort actions.⁴² Bankruptcy courts cannot enter final judgments on non-core state tort actions without consent of the litigants or district court review.⁴³

(2) The Trustees

The trustees are the official representatives of the bankruptcy estate, and they have a fiduciary duty to the bankruptcy estate and the creditors. There are different types of trustees that you may encounter in a bankruptcy such as the US Trustee, a Chapter 7 Trustee, Chapter 11 Trustee, and a Standing Chapter 13 Trustee. The Office of the U.S. Trustee (“UST”) serves the important function of oversight of bankruptcy proceedings.⁴⁴ The UST is part of the U.S. Department of Justice and has the authority to “raise and be heard on any issue in any case or proceeding under [the Bankruptcy Code].”⁴⁵ The Bankruptcy Code gives the UST broad authority to oversee bankruptcy proceedings “roughly akin to an amicus party, in assisting bankruptcy judges efficiently and effectively perform their functions.”⁴⁶ The UST appoints and supervises other types of trustees, and monitors the progress of cases to prevent undue delay.⁴⁷ A Chapter 7 Trustee is appointed by the UST to collect and liquidate the debtor’s assets, to distribute proceeds to creditors, to investigate the debtor’s financial affairs, and pursue viable litigation claims under

⁴⁰ 28 U.S.C. § 1334(a).

⁴¹ 28 U.S.C. § 152(a)(1).

⁴² See *Stern v. Marshall*, 564 U.S. 462, 499 (2011). The issue of what comprises a “core” and “non-core” proceeding was central in *Stern v. Marshall*. An in-depth discussion of the *Stern* holding is beyond the scope of this overview. However, since its ruling, bankruptcy courts cannot enter final judgments on non-core state tort actions without consent of the litigants or district court review. In *Stern*, the Supreme Court struck down 28 U.S.C. § 157(b)(2), which provided that such counterclaims were core proceedings.

⁴³ *Id.*

⁴⁴ Paul A. Avron, *Trustees in Bankruptcy Proceedings*, *The Federal Lawyer* 6 (June/July 2018).

⁴⁵ 11 U.S.C. § 307.

⁴⁶ Avron, *supra* n. 43 at 6.

⁴⁷ *Id.*

the Bankruptcy Code.⁴⁸ A Standing Chapter 13 Trustee is appointed by the UST to collect and distribute a debtor's earnings under a chapter 13 repayment plan. The Chapter 13 Trustee acts "as a disbursing agent for creditors during the plan process and to represent the unsecured creditor class in terms of ensuring that the debtor pays as much as possible to unsecured creditors."⁴⁹ The Chapter 7, 11, and 13 Trustees are paid an administrative fee from the bankruptcy estate, which is an underlying interest that should be considered when mediating with a trustee.

(3) The Debtor or Debtors

Only a persons who "resides or has a domicile, a place of business, or property in the United States or a municipality, may be a debtor" under the Bankruptcy Code.⁵⁰ In general, a debtor can be an individual, corporation, partnership, limited liability company, or municipality. Specific debtor eligibility requirements are provided for each chapter of the bankruptcy code. For example, under chapter 7, a railroad, insurance companies, and banks are excluded from being debtors.⁵¹ Under chapter 9, only municipalities may be debtors.⁵² Under chapter 12, only family farmers, family ranchers, or family fishermen with regular incomes from those endeavors may be debtors.⁵³ Under chapter 13, only persons with regular incomes that owe less than \$394,725 in unsecured debts and less than \$1,184,200 in secured debts may be debtors.⁵⁴

(4) Other Parties in Interest

Other parties in interest in a bankruptcy case may include any person or entity that has a financial stake in the outcome of the proceeding. For example, depending on the type of action, there may be individuals who have a partial interest in the property in dispute as a joint titleholder, who are not necessarily named as a party to the litigation, but who nonetheless may see their partial property interest sold. Such parties may include family members, creditors, opposing parties in non-bankruptcy litigation matters, co-debtors, contractors, or any other person or entity that may have a personal or financial relationship to the debtor.

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ 11 U.S.C. § 109(a).

⁵¹ 11 U.S.C. § 109(b).

⁵² 11 U.S.C. § 109(c).

⁵³ 11 U.S.C. § 109(d).

⁵⁴ 11 U.S.C. § 109(e).

BANKRUPTCY BASICS OUTLINE

By Robertson Cohen

I. What is Bankruptcy?

- A. Fundamental purpose is to provide honest but unfortunate debtors with a “Fresh Start”
 - 1. Honest. BK courts are very sensitive to dishonest behavior. All transactions must be arms length. DO NOT sign over/transfer assets to friends and family (not only is this a bad idea, chances are good it is protected anyway);
 - 2. Unfortunate. Similar to above. Be wary of serial filers (multiple filings with a short duration); and
 - 3. Fresh Start. Goal of BK is to provide a fresh start. Everything is geared towards that end (i.e., exemptions, more on that below).
- B. Promotes uniformity in debtor/creditor laws (before 1979 act generally was regulated by states with lots of variations);
- C. Prevents creditors from taking unfair advantage of debtors (Automatic Stay, Violations include actual damages and punitive if willful);
- D. Provides a mechanism for distributing the debtor’s assets equally among his or her creditors (protects even unsophisticated creditors);
- E. Secures a prompt and effectual administration and settlement of the debtor’s estate within a limited period (this is debatable... UST & TT tend to drag their feet, sometimes overworked, sometimes strategic); and
- F. Establishes priorities among creditors (e.g., maintenance child support; taxes; professional fees; debts owed to persons debtor injured while intoxicated, etc...)

II. Bankruptcy Basics

- A. **Chapter 7 Liquidation** (most common; can do *pro se* if absolutely necessary; be careful re “petition preparers”, some good, some bad)
 - 1. How to file a simple case:
 - (a) Intake with the client (see appendix)
 - (b) Get documents from client (see appendix)
 - (c) Download “Chapter 7 Voluntary Petition Packet” & Complete with

Client¹

- (d) Get a free credit report or two at www.annualcreditreport.com
 - (e) Bring it back the clinic for a proof reading
 - (f) Drop it off at the clerks office
 - (g) *BK Court has a lot of resources and *pro se* clinics
2. Asset Case. Example of how it works when its an asset case (but see below, this is the exception not the rule): Single filer, \$20,000 Harley Davidson, No Loan, Files Chapter 7. TT will take the Harley, sell it at auction, give exemption amount to Debtor (\$5k if not elderly or disabled), take his/her cut, remainder goes to creditors, if not all creditors paid in full, remaining creditors are discharged.
3. No Asset Cases. Vast majority of cases are no asset cases. Meaning everything owned by debtor is protected by an exemption. Thus practical effect is keep all of stuff and discharge all debt.
4. Means Test(i.e. qualifying for a Chapter 7). Average out last 6 months of income, multiply by 12, and compare that annual figure with the median income² for the debtors household size in the state. If over, then can take certain deductions, but, even if with deductions still over, a rebuttable presumption of abuse arises (e.g., get a lawyer, because although you can rebut the presumption the UST will likely at minimum investigate and probably file an objection to discharge and try to force debtor into a Chapter 13.) 11 U.S.C. 707(b)(2). But if do pass then move on to test #2.

2020 Median Income Numbers:

	1 Earner	2 People	3 People	4 People*
COLORADO	\$66,942	\$87,103	\$95,050	\$114,066

*Add \$9,00 for each individual in excess of 4.³

5. “Disposable Income Test”⁴. Net income after expenses, based on past and looking forward (is actually based in reality rather than the Means Test which has many, many flaws) compared with *actual, normal, reasonable*,

¹ Can also get an intake packet and have the client complete it on their own time.

² <http://www.usdoj.gov/ust/co/bapcpa/meanstesting.htm> to find current median income figures.

³ <https://www.justice.gov/ust/means-testing>

⁴ This is what I call it. There are many ways to describe it, disposable income isn't very precise, but it gets the point across to the clients.

living expenses (not including payments on dischargeable debt or debt getting rid of like a car payment). If break even, pass, can do a 7. If upside down, pass, can do a 7. If have disposable income then probably no pass and should do a 13. 11 U.S.C. 707(b)(3).

B. Chapter 13 Reorganization (about 20% of cases; probably not so much for poverty law; complicated, need atty;)

1. Less of “reorganization” as the consumer usually would view the term. Basically, take whatever disposable income have left over after normal, necessary, reasonable, monthly living expenses and pay for a minimum 36 to maximum 60 months. C 13 TT will then distribute to all creditors who filed Proof’s of Claims.
2. Basic Idea. If you can afford to pay back some of your debt, do so. If not, then do a 7.
3. Push & Pull Factors. Save House in a 13! Retain non-exempt assets that would lose in a 7! Co-Debtor stay! Strip-down on 2nd mortgages and cram-down cars! Current pending legislation which would let Debtor cram-down 1st mortgages? Broader discharge (e.g., more things are discharged, such as non child support and maintenance, willful & malicious injury)! Discharge not required to file (helpful for those not eligible for a 7 but still need some protection)!

C. Chapter 11 Reorganization (generally not for consumers and certainly not for poverty law; need specialized atty)

Assets

1. Property of the Estate. Upon filing all of debtors assets become property of the estate; theoretical transferred⁵ to the bk court. Will not come take a U-Haul (very common question).
2. Property of the Estate is Protected. Automatic stay protects all property of the estate.

D. Automatic Stay

1. Automatic Stay prevents execution against debtor’s property and continuation of legal proceedings, with a few exceptions like parenting time

⁵ Technically this is incorrect, there is no “transfer”. The estate just comes into existence. For example, this is in part why *ipso facto* clauses in corporate agreements conditioning ownership interest upon involuntary transfers aren’t impacted by a bankruptcy filing (i.e., there was no transfer).

determination, divorce and others that don't really apply to property law.

2. In re Gagliardi, 290 B.R. 808, 814 (Bankr. D. Colo. 2003)

- (a) Creditor proceeded with an eviction after bk filed;
- (b) Court ruled that pursuant to Colorado law title to real property on which a foreclosure sale has been conducted remains in the property owner until expiration of redemption rights;
- (c) As of the bankruptcy filing the Debtors had three remaining property interests in the Property: (1) legal title; (2) a right of redemption; and (3) a legal right of possession.
- (d) Court awarded **actual** and **punitive** damages.

E. **Exemptions** (Stuff you can keep)

- 1. Debtor is permitted to retain "exempt property." Promotes the concept of the "Fresh Start." (Hard to start fresh without clothing, HH goods, etc...)
- 2. Federal vs. State Exemptions. Colorado has opted out of the federal exemptions. However other federal exemptions apply (e.g., Qualified Retirement; Social Security, etc...).
- 3. Current commonly used Colorado Exemptions for poverty law situations (§14-54-102 *et seq.*; *but Real Property/Mobile Homes §38-41-201 et seq.*):
 - (a) Homestead - \$75k equity; but \$105k if elderly or disabled;
 - (b) Health Aids – Unlimited (e.g., wheel chairs, hearing aids, etc...)
 - (c) Automobile – All auto's \$7,500k equity for only 2 cars (\$15,000 if elderly or disabled);
 - (d) Tax Refunds – Not exempt but for the Child Tax Credit & EIC;
 - (e) Household Goods - \$3k per person; value not at retail!;
 - (f) Jewelry - \$1,500 per person;
 - (g) Earnings – 75% exempt. No exemption for cash on hand. Money under the mattress is not protected!;
 - (h) Wearing Apparel - \$2,000 per person; and
 - (i) Tools of Trade - \$30,000 equity per person for primary; \$10,000 for other gainful occupation.

G. **Discharged Debts**

- 1. Unsecured Debts: Most Unsecured Debts are dischargeable such as Credit Cards, Medical Bills, Lines of Credit (unsecured), NSF checks (potential) for fraud, but very hard to prove), Not Child Support and Maintenance (only in a 13!; good push factor though to a 13 if feasible)

2. Secured Debts: Secured debts are dischargeable (e.g., surrender a house or car, but if want to keep it, must keep paying for it!)

H. Non-Dischargeable Debts

1. Unsecured Debts: Student Loans and Taxes (is complicated, can be dischargeable sometimes if: 3 Yr Rule; 2 Yr Rule; 240 day rule; need atty); Child Support & Maintenance; Restitution;
2. Fraudulent Debts; Willful & Malicious injury; Breach of Fiduciary Duty (but discharged if the creditor does not timely object, so long as has proper notice)
3. Secured Debts: Debts that are reaffirmed.
4. Domestic Support Obligations
5. Non-Domestic Support Obligations

Treatment in Chapter 7 vs: Treatment in Chapter 13

Debt to be Discharged:	Chapter 7	Chapter 13
Domestic Support Obligations	No	No
Non-Domestic Support Obligations	No	Yes*

(a) Making Dischargeable Non-DSO into a non-dischargeable DSO

(b) Under Tenth Circuit law for a debt to be treated as “alimony, maintenance, or support” it must be shown that: (1) **the intent** of the parties agreeing to it or the court imposing it was for the debt to be support; and (2) the debt is, **in substance**, support.”⁶

- (1) Intent – is it really a DSO
- (2) Labels – Do not bind the bankruptcy court
- (3) Income & Needs – at time of Dissolution not the BK

⁶ In re Sampson, 997 F.2d 717 (10th cir.1993); Shaver v. Shaver, 736 F.2d 1314 (9th Cir. 1984); In the Matter of Benich, 811 F.2d 943 (5th Cir.1987).

J. Common Questions/Issues - FAQ:

1. Pre-Bankruptcy Planning, is it ok? – Yes is not *per se* BK fraud, but be careful, get atty. Essentially you take non-exempt assets and convert them to exempt assets.
2. In re Beaudin, No. 09-35557 EEB, 2010 WL 3748735 (Bankr. D. Colo. Sept. 21, 2010)
 - a. Facts: Debtor converted \$3,179 of non-exempt funds into an exempt IRA the day of bankruptcy filing.
 - b. Court ruled that is acceptable pre-bankruptcy planning, factors to consider:
 - (1) whether the conversion was disclosed or concealed;
 - (2) whether the debtor was being sued or threatened with suit when the conversion was made;
 - (3) whether the conversion was of substantially all of the debtor's assets;
 - (4) whether the debtor absconded;
 - (5) whether the debtor removed or concealed assets;
 - (6) whether the debtor was insolvent or became insolvent shortly after the conversion;
 - (7) whether the conversion occurred shortly before or shortly after a substantial debt was incurred;
 - (8) whether the debtor retained control of the property transmuted;
 - (9) the value of the asset claimed as exempt;
 - (10) the proportion of the debtor's non-exempt assets converted into exempt form;
 - (11) whether the debtor borrowed funds to acquire the exempt asset;
 - (12) whether the debtor intended to use the exempt asset for the legislative purpose behind the claimed exemption;
 - (13) whether the debtor misrepresented any aspect of the transaction;
 - (14) whether and to what extent nonexempt assets remain available for distribution to creditors;
 - (15) whether the asset was a long-term holding that the debtor converted in contemplation of bankruptcy;
 - (16) whether the debtor's acquisition of the exempt asset deviated from his historical conduct;
 - (17) whether the debtor sought legal advice prior to purchasing the exempt asset, and
 - (18) the proximity in time between the act of conversion and

the debtor's bankruptcy filing.

3. Effect on credit? Car Ins? – 7-10 years on CR, though easier to rebuild credit with a BK than without. Easiest way is to get a secured credit card to \$500 in the bank, pay it off every month.
4. Is it published? – Never seen it happen, though is public record.
5. Non-Dischargeable Debt. – Myth: Credit card debt is not discharged. Wrong, credit card debt is still dischargeable, like most unsecured debt. Can surrender secured property without recourse. Watch out for student loans an recent and non-filed taxes.
6. What if don't list all creditors or miss one? – hopefully not an asset case in a C 7 or a C 13 because if it is the debt is not discharged. If no asset case ok, debt is still discharged.

Appendix ⁷
**Sample Clinic Intake Sheet for
 Bankruptcy with Comments**

Question	Y/N (If Yes Consider Atty)
1. Have you lived anywhere other than Colorado for the past 2 years? • Use state resided in exemptions, could be beneficial or harmful to client	<input type="checkbox"/> yes; <input type="checkbox"/> no
2. Have you paid any single creditor more than \$600 total in the last 90 days? • TT can avoid preference payments	<input type="checkbox"/> yes; <input type="checkbox"/> no
3. Have you paid back any family members or friends in the pas year? • TT can avoid insider preference payments	<input type="checkbox"/> yes; <input type="checkbox"/> no
4. Have you transferred any property in the past year? 4 Years? • Be on the lookout for fraudulent transfer issues	<input type="checkbox"/> yes; <input type="checkbox"/> no
5. Have you been divorced? • Determine if there is non-dso debt owing, maybe 13 would be better for the client	<input type="checkbox"/> yes; <input type="checkbox"/> no
6. Are you owed a tax refund? • Non-exempt property, TT will take if meaningful value, wait to file bk?	<input type="checkbox"/> yes; <input type="checkbox"/> no
7. Does anyone owe you money? Can you sue anybody? • TT may pursue all accounts receivable if there is meaningful value	<input type="checkbox"/> yes; <input type="checkbox"/> no
8. What is your <i>household</i> gross monthly income from all sources including employment, social security, pension, child support/maintenance, other: _____ • Help determine means test and disposable income testing; ok to be approximate	N/A
9. What are your <i>household</i> monthly expenses: Rent/Mortgage: _____ Car #1: _____ Car #2: _____ Car #3/Other: _____	N/A

⁷ Not an exhaustive list, but should catch 90% of the problems, especially for a MVL case that doesn't have a lot of issue.

<p>Estimated Necessities (e.g., food, clothing, utilities, recreation): _____</p> <p>Medical Insurance: _____</p> <p>Medical Prescriptions & Co-Pays: _____</p> <p>Gasoline/Transportation: _____</p> <p>Student Loans: _____</p> <p>Rqd Child Support/Maintenance: _____</p> <p>Estimated Monthly Taxes: _____</p> <p style="text-align: right;">Total: _____</p> <ul style="list-style-type: none"> • Help determine means test and disposable income testing; ok to be approximate; if about breakeven or obviously upside down, then 7; if not refer to atty; 	
<p>10. Past bankruptcies?</p> <ul style="list-style-type: none"> • 2 yrs between 13's; 7 yrs between 13 then 7; 4 years between 7 and then 13; 8 years between 7's 	<input type="checkbox"/> yes; <input type="checkbox"/> no
<p>11. Owe Taxes or Student Loans?</p> <ul style="list-style-type: none"> • Some taxes can be discharged, if owe lots then should probably find atty; • Student loans not discharged in general, but hardship if client in position not to repay (physical or mental, can't be same state when incurred the debt); very complicated, find atty; 	<input type="checkbox"/> yes; <input type="checkbox"/> no
<p>12. Need to stop a foreclosure <u>and</u> save house?</p> <ul style="list-style-type: none"> • Find atty; can only do in a 13; 	<input type="checkbox"/> yes; <input type="checkbox"/> no
<p>13. Other:</p> <p>_____</p>	

Appendix

Common Documents you will need from the Client

- 6 Months of paystubs (or other proof of income)
- Last 2 years of taxes
- Credit Counseling Certificate
- Bills (cross reference with the credit report; not all bills are on the credit report; and no you can't exclude creditors, they all go in);
- 2-3 Months of Bank Statements
- Court Pleadings (e.g., domestic relations, demand for money judgment)

NOTE ANY WORKSHEET YOU GIVE TO THE CLIENT TO ANSWER QUESTIONS IS POTENTIALLY NOT COVERED BY ATTORNEY CLIENT PRIVILEGE! - WHICH IS WHY WE SUGGEST, AT LEAST FOR THE ONE OFF MVL CASE, TO JUST DO THE WORK WITH THE CLIENT IN THE OFFICE