International Journal of Business Management and Commerce; Vol. 5 No. 3; October 2020
International Journal of Business Management and Commerce
Published by Center for Contemporary Research

Managing Financial Stress for Debtors and Creditors in the Midst of a Pandemic Part II: Bankruptcy

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Abstract

Part two of this series deals with the rights and duties of both creditors and debtors in the bankruptcy process, dealing with Chapter 7 Liquidation Proceedings, Chapter 11 Reorganizations, and Chapter 13 Adjustment of Debts. Chapter 7 permits the debtor through a trustee to liquidate nonexempt property and discharge debts within three to six months. Under Chapter 11, the debtor commits to a payment plan to repay a portion of debts and discharges the remaining debt. In a Chapter 13 proceeding, the debtor commits to a three- to five-year payment plan. Upon completion of the plan, remaining debts are discharged. The article relies on significant law reviews and other law and finance related articles, statutory materials, and important cases explicating the major aspects of bankruptcy as the law affects both creditors and debtors.

Key Words: Bankruptcy, "fresh start," discharge, exemptions, non-dischargeable debts, "wild card"

1. Introduction

Until the Coronavirus pandemic hit with full force in March of 2020, the economy of the United States seemed to be on a healthy trajectory. United States Courts (2020) reports that "The level of bankruptcy filings in 2019 was 51 percent below the peak reached in 2010, during the aftermath of the Great Recession (2007-2009) when 'a national wave of bankruptcies that began in 2008 reached a peak in the year ending September 2010, when nearly 1.6 million bankruptcy cases were filed.'" [See Table I for information on bankruptcy filings from 2010 through 2018.]

But there were some early warnings of potential difficulties. United States Courts (2020) reported that "Bankruptcy filings increased slightly for the 12-month period ending Dec. 31, 2019, compared with cases for the year ending Dec. 31, 2018."

However, the situation radically changed in March of 2020. White (2020) writes: "The U.S. economy crashed in historic fashion this year. 'This is obviously the ugliest quarter we've ever seen in our history,' [stated] Edward Moya, senior analyst at currency trading firm OANDA, said of initial second quarter gross domestic product numbers… . The economy took a massive gut punch in the second quarter, with estimates for an annualized decline of 30 percent or more — the biggest drop on record — as restaurants, bars, stores and other businesses shut down, many for good, and many Americans remained largely shuttered in their homes."

Skeel (2020) commented: "Less than two months into the coronavirus crisis, and despite the massive infusion of federal funds, a rise in business bankruptcies has already begun. Even if the current efforts by Congress, the Federal Reserve, and Treasury to counteract the economic shutdown are effective, an enormous wave of bankruptcies may come. How effective will the bankruptcy system be as a second line of defense for consumers and businesses that are unable to avoid default?" In terms of personal bankruptcies, Zuckerman (2020) added that "More older Americans are filing for bankruptcy nowadays than 25 years ago."

Dealing with the severe negative aspects of the pandemic on the economy (Burgess & Green, 2020) provides an opportunity to undertake a study of bankruptcy, as society deals with the economic and social costs of debt on both creditors and debtors in that context.

2. Bankruptcy: Origin and Purpose

The United States Constitution authorizes Congress to enact "uniform Laws on the subject of Bankruptcies" (Darling, Hotze, & Blumberg, 2018). Congress enacted the current "Bankruptcy Code" in 1978 [*Bankruptcy Reform Act of 1978*] which has been amended several times since its initial enactment—most importantly in 2005.

The purpose of federal bankruptcy laws is to give a debtor a financial *"fresh start"* from burdensome debts. As noted by the United States Supreme Court in *Local Loan Co. v. Hunt* (1934) "[I]t gives to the honest but unfortunate debtor… a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."

The key goal of the federal bankruptcy scheme is accomplished through the bankruptcy *discharge* (*Perez v. Campbell,* 1971), which releases a debtor from personal liability from specific (scheduled) debts and prohibits creditors from taking action against the debtor to collect those debts (Rendleman, 1980).

The Ascent found the main causes of bankruptcy to be:

- Income loss
- Medical expenses
- Tied to helping friends or relatives
- Student loans
- Divorce or separation
- Change to family size such as birth or death (see also Cussen, 2020)

There are six major forms of bankruptcy, the most important of which will be considered in this article.

- Chapter 7: Liquidation
- Chapter 9: Adjustment of Debts of a Municipality
- Chapter 11: Reorganization
- Chapter 12: Adjustment of Debts of Family Farmers and Fisherman
- Chapter 13: Adjustment of Debts of Individuals\
- Chapter 15: Cross Border Issues

In addition to the protections found under federal law, states also may enact provisions that relate to their citizens filing for bankruptcy, usually providing for a series of state "exemptions" that may differ from those provided under federal legislation.

2.1. The Process

The United States bankruptcy judge, a judicial officer of the United States District Court, presides over bankruptcy cases. The bankruptcy judge enjoys wide discretion (*In re U.S. Golf Corporation*, 1981; *In re Lionel Corporation*, 1983) in areas such as the eligibility of an individual or an entity to file for bankruptcy, or whether a debtor should receive a discharge of debt obligations (Gennaioli & Rossi, 2010; Tribble, 2018).

In cases filed under Chapters 7, 12, or 13, and in some cases under Chapter 11, the process is carried out by a *trustee,* who is appointed by the bankruptcy court to oversee the management of the case (see Avery, 2020). Surprisingly, a debtor's direct involvement with a judge in a bankruptcy proceeding is very limited. A typical Chapter 7 debtor will *not* make a court appearance and will not appear before the bankruptcy judge unless an objection to discharge is raised in the case (United States Courts, 2020).

A Chapter 13 debtor may appear before the bankruptcy judge at a hearing to confirm a reorganization plan. In reality, the only formal proceeding at which a debtor is required to appear is the meeting of creditors, which usually takes place at the offices of the bankruptcy trustee. This meeting is informally called a “341 Meeting**,**” because the meeting is held pursuant to section 341 of the Bankruptcy Code which requires that the debtor attend the meeting so that creditors can directly question the debtor and inquire about debt and any property that might be available for payment to creditors (see Lapas, 2020).

In *In re Clemons* (1993, p. 863), the Bankruptcy Court noted:

> “… because the Section 341 meeting is clearly nonadjudicativein nature, it has none of the characteristics of a tribunal or judicial court, nor does the questioning of the debtor constitute pleading the cause of another. The meeting is simply for the purpose of gathering information, not for taking legal action or seeking relief from the court. The trustee presiding over the meeting has no authority to decide disputes, and the court, which will eventually decide any such disputes, is not even permitted to attend the meeting.”

Lapas (2020) provides the following detailed commentary about the “341 Meeting”:

> “Typically, the trustee will ask whether you reviewed the petition and whether it accurately lists all of your assets and all of your debts. The trustee may ask about how you valued the property that you listed on your petition. If you filed a chapter 13 case, the trustee will probably repeat the plan provisions in very general terms to make sure that he or she understands what your plan proposes and to make sure that you understand what your plan is proposing. In my district, typical creditors’ meetings rarely last more than 5 minutes.”

3. Chapter 7: Liquidation

Groff (2020) provides an interesting context to the issues surrounding a potential bankruptcy filing and writes: “It’s important for business owners and executives to be aware of early warning signs that their company could be in financial trouble. Recognizing these signs when they first emerge could be the difference between a Chapter 11 restructuring or losing the entire business in a Chapter 7 liquidation.”

Key warning signs identified by Groff (2020) include:

- Continued decreases in cash flow
- Low cash or capital balance
- Departure of key management or employees
- Inability to meet debt obligations such as loans and lease payments
- Key debt covenants are or soon to be breached
- Difficulty meeting payroll
- Increased interest rates on credit cards due to late payments
- Consistent calls from creditors
- Company executives considering injecting more personal money into the business to satisfy debts or payroll

Chapter 7 involves **“**an orderly, court-supervised procedure by which a trustee takes over the assets of the debtor’s estate, reduces them to cash, and makes distributions to creditors, subject to the debtor’s right to retain certain exempt property and the rights of secured creditors” (Groff, 2020).

In many cases, there may be few “non-exempt” assets, such that there may not be an actual liquidation of the debtor’s assets. These cases, called “*no-asset cases*,” "… allow the closing of the case and to avoid unnecessary administration expenses at the clerk's office" (*Kipp Flores Architects, L.L.C. v. Mid-Continent Co.*, 2017, p. 326). Generally speaking, an unsecured creditor will receive a distribution from the bankruptcy estate only if the case is an “asset case” and the creditor files a proof of the claim with the bankruptcy court in a timely manner.

3.1. Chapter 7: Details

The bankruptcy trustee is responsible to gather or marshall and then sell or liquidate the non-exempt property of a debtor and then to apply the proceeds of the sale or disposition of such assets to pay holders of claims (creditors) in accordance with the provisions of the Bankruptcy Code.

Part of the debtor's property may be subject to valid liens, mortgages, and perfected security agreements under Article 9 of the Uniform Commercial Code that establish the priority rights of a creditor or which pledge the property to other creditors (*Paloian v. LaSalle Bank National Association*, 2013).

An individual, a partnership, a corporation, or other business entity may qualify for bankruptcy relief under Chapter 7. However, an individual debtor may be subject to a "means test" (*In re Austin*, 2007) to determine eligibility under the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* (Jensen, 2005; Baker, 2019), which Jensen (2005, p. 485) noted was "one of the most comprehensive overhauls of the Bankruptcy Code in more than twenty-five years." If a debtor's income is in excess of certain statutory thresholds, the debtor may not be eligible for Chapter 7 relief.

In addition, an individual is precluded from filing under Chapter 7, or under any other Chapter, if during the preceding 180 days a prior bankruptcy petition was dismissed due to the debtor's willful failure to appear before the court or to comply with any orders of the court, or the debtor voluntarily dismissed the previous case after creditors sought relief from the bankruptcy court to recover property upon which they held valid liens (*In re Hill*, 2003; see O'Neill, 2020a).

3.2. Chapter 7: Procedures

A case filed under Chapter 7 begins with the debtor filing a *petition* with the bankruptcy court with jurisdiction serving the geographic area where the individual resides or where the business debtor is organized or has its principal place of business or principal assets (*In re Seven Springs Apartments*, 1983; see Nicks, 2020).

Nicks (2020) notes that there are four basic types of bankruptcy petitions:

- **"Voluntary Petition for Individuals Filing for Bankruptcy**. This form is for individuals who are filing a case on their behalf. Most filers use this form.
- **Voluntary Petition for Non-Individuals Filing for Bankruptcy**. Business entities, such as corporations, partnerships. and municipalities that want to file for bankruptcy (a voluntary case) will use this form.
- **Involuntary Petition Against an Individual**. In some cases, a creditor, rather than the debtor (the person who owes debt) will force a debtor into bankruptcy. This is the involuntary bankruptcy form that a group of creditors would use to file a bankruptcy case against an individual.
- **Involuntary Petition Against a Non-Individual**. This form gets used when a group of creditors forces a corporation, partnership, or another entity that is not an individual into bankruptcy."

Darling, Hotze, and Blumberg (2018) note that "bankruptcy proceedings and documents filed in bankruptcy cases may contain a wealth of financial information. Testimony is taken under oath during various types of proceedings, and may require documents signed under penalty of perjury."

In connection with filing the bankruptcy petition, the debtor must file the following with the court:

(1) Schedules of assets and liabilities;
(2) A schedule of current income and expenditures;
(3) A statement of financial affairs; and
(4) A schedule of executory contracts and unexpired leases.

In addition, a debtor must also provide the trustee with copies of various relevant tax returns. Individual debtors with primarily *consumer debt* (Auclert, Dobbie, & Goldsmith-Pinkham, 2019; Exler & Tertilt, 2020), for purchases of goods for "personal, family, or household use" must also file "a certificate of credit counseling" and a copy of any debt repayment plan developed through credit counseling (*Miller v. Advantage Credit Counseling Services*, 2006); "evidence of payment from employers, if any, received 60 days before filing; a statement of monthly net income and any anticipated increase in income or expenses after filing; and a record of any interest the debtor has in federal or state qualified education or tuition accounts" (United States Courts, 2020). A husband and wife may either file a joint petition or individual petitions. Even if filing jointly, a husband and wife are subject to all the document filing requirements required of individual debtors.

Finally, in order to complete filing process, the debtor will provide the following information to the bankruptcy court:

(1) A list of all creditors and the amount and nature of their claims;
(2) The source, amount, and frequency of the debtor's income;
(3) A list of all of the debtor's property; and
(4) A detailed list of the debtor's monthly living expenses, *i.e.*, food, clothing, shelter, utilities, taxes, transportation, medicine, etc.

The debtor may also file a schedule of property that the debtor claims is *exempt under federal bankruptcy law or under the laws of the debtor's home state* under a provision in the Bankruptcy Code that permits an individual state to adopt its own exemptions in place of the federal exemptions. In some jurisdictions, the individual debtor has the option of choosing between federal exemptions or the exemptions available under state law (see Armstrong, 2018).

In *Davis v. Davis* (1992, p. 478), the Fifth Circuit Court of Appeals noted:

> "Exemptions have been perennially controversial, because they reduce assets potentially available to pay creditors and arouse charges of abuse of bankruptcy. Exemptions are also fought over by states'-rights advocates, who value the traditional state legislative prerogative to adjust exemptions to local economic conditions, and by advocates of federal uniformity, who want to raise -- or lower -- exemptions based on conceptions of national equity. Congress allayed the controversy between state and federal advocates by providing in the 1978 Bankruptcy Code that states could opt out of prescribed federal exemptions altogether or could allow their citizens to select either schedule. See 11 U.S.C. § 522(b).)"

The bankruptcy clerk will provide notice of the bankruptcy case to all creditors whose names and addresses are provided by the debtor.

Filing a petition under chapter 7 **"**automatically stays**"** (stops) most collection actions against the debtor or the debtor's property (*In re Charles Stringer*, 1998; Lubben, 2019), including lawsuits, wage garnishments, or any telephone calls demanding payments.

3.3. The Bankruptcy Trustee

In addition to marshaling the assets of the bankruptcy estate, the trustee in bankruptcy may also attempt to recover money or property under the trustee's "avoiding powers." The trustee's avoiding powers include the power to:

- Set aside *preferential transfers* made to creditors within 90 days before the petition (*Nelson Co. v. Counsel for the Official Committee of Unsecured Creditors*, 1992);
- Undo security interests and other pre-petition transfers of property that were not properly perfected under Article 9 of the Uniform Commercial Code at the time of the petition (*Missoula Federal Credit Union v. Reinertson*, 1999); and
- Pursue non-bankruptcy claims such as fraudulent conveyance (e.g., *Redmond v. NCMIC Financial Corporation,* 2017) and bulk transfer (*In re TK Holdings, Inc.*, 2018) remedies available under state law (Norberg, 2019).

In addition, if the debtor is a business, the bankruptcy court may in its discretion authorize the trustee to operate the business for a limited period of time (*In re Northstar Offshore Group*, 2020), if the court concludes the operation will benefit creditors and enhance the liquidation of the estate.

4. Distribution of Property

Section 726 of the Bankruptcy Code governs the distribution of the property of the estate based on the priorities established in the Act (Flores-Szwagrzak, Garcia-Segarra, & Gines-Vilar, 2019). [A priority claim is an unsecured claim which must be paid in full ahead of the other unsecured claims in a bankruptcy proceeding.] Under Section 726, there are six classes of claims. Examples of priority claim includes unpaid wages, spousal or child support, administrative expenses of the bankruptcy action, certain contributions to an employee benefit plan, certain claims of farmers and fishermen, certain consumer claims, certain unsecured tax claims and certain wage, salary, or commission claims (see *Wilson v. Allegheny International, Inc.*, 1991).

5. The Chapter 7 Discharge

A discharge releases an individual debtor from personal liability for most debts (providing for the "fresh start") and prevents creditors from taking any further collection actions against the debtor relating to any discharged debts.

However, Section 523(a) of the Code specifically excepts and makes non-dischargeable various categories of debts to individual debtors (*Bullock v. BankChampaign, N.A.*, 2013). Therefore, the debtor must still repay those debts after bankruptcy. Congress has determined that these types of debts are not dischargeable for public policy reasons (based either on the nature of the debt or the fact that the debts were incurred due to improper behavior of the debtor, such as the debtor's drunken driving) (see *United States v. Doyle*, 2003).

There are *19 categories* of debt (*In re Jones*, 2006) excepted from discharge under the various bankruptcy laws (generally *Royal American Oil & Gas Company v. Szafranski*, 1992). Generally speaking, the exceptions to discharge apply *automatically* if the language prescribed by section 523(a) applies. The most common types of non-dischargeable debts are certain types of tax claims, debts not set forth by the debtor on the lists and schedules the debtor must file with the court (called "non-scheduled debts"), debts for spousal or child support or alimony, debts for willful and malicious injuries to person or property, debts to governmental units for fines and penalties, debts for most government funded or guaranteed educational loans (White, 2019) or benefit overpayments, debts for personal injury caused by the debtor's operation of a motor vehicle while intoxicated, debts owed to certain tax-advantaged retirement plans, and debts for certain condominium or cooperative housing fees (*In re Jones*, 2006).

5.1. Debts Not Dischargeable If a Creditor Objects

There are some debts that are not subject to automatic non-dischargeability. Creditors must seek a determination by the bankruptcy court in an adversary proceeding to determine if such debts are dischargeable or not. If the creditor doesn't raise the issue of dischargeability or if the creditor raises the issue but the court doesn't agree, these debts will be discharged. O'Neill (2020a) outlines the types of debt that may be non-dischargeable, but only if a creditor otherwise objects to their discharge:

- "Credit card purchases for luxury goods. When owed to a single creditor and aggregating to more than $725 (as of April 1, 2019) and incurred within 90 days of filing for bankruptcy, these debts are presumed fraudulent and nondischargeable. If a debtor can prove that he or she intended to pay the charges back or that the goods aren't "luxury" items then the debt will be discharged" (*American Express Centurion Bank v. Owens*, 2013; see also Landry, 2019).
- "Cash advances. When a debtor obtains more than $1,000 (as of April 1, 2019) from one creditor within 70 days of filing for bankruptcy, the debt is presumed fraudulent and non-dischargeable. Again, if a debtor can prove that he or she intended to pay this money back, then the debt will be discharged" (*National City Bank v. Manning*, 2002).
- "Debts obtained by fraud or false pretenses. These types of cases tend to stem from misrepresenting income on credit applications or purchasing goods and services on credit with no intent to pay" (*Deodati v. M.M. Winkler & Associates*, 2001).
- "Debts incurred due to willful and malicious injury. A debtor won't be able to discharge a debt arising from intentionally injuring someone or someone's property" (*America First Credit Union v. Gagle*, 1999).

Secured creditors, as determined by Article 9 of the Uniform Commercial Code, may retain rights to seize property which secures an underlying debt or obligation even after a discharge is granted (*Graham v. Connor*, 1989).

Depending on individual circumstances, if a debtor wishes to keep certain secured property (such as an automobile), he or she may decide to "reaffirm" the debt unless the reaffirmation would "pose an undue hardship on the debtor" as determined by the bankruptcy court (*In re Kamps,* 1998; see also Bunce, 2016). A reaffirmation is an agreement between the debtor and the creditor that the debtor will pay all or a portion of the money owed, even if the debt had been discharged in the bankruptcy. If a debtor decides to reaffirm a debt, he or she must do so *before* the discharge is entered. The debtor must sign a written reaffirmation agreement and file it with the court.

5.2. Non-Exempt and Exempt Property **(FindLaw, 2018; Maddox, 2018)*:***

Armstrong (2018) states that:

> "When an individual or a married couple files a bankruptcy case, they are not required to turn over all they own to the court and creditors…. Only individuals can have exempt property. The assets of a corporation filing Chapter 7 bankruptcy will be liquidated in full. The assets of a corporation filing a Chapter 11 reorganization will generally not be liquidated unless the corporation chooses to do so to fund a reorganization plan."

Non-exempt property includes:

- Expensive musical instruments, unless the debtor is a professional musician;
- Collections of stamps, coins. Baseball cards and other collectibles;
- Family heirlooms;
- Cash, bank accounts, stocks, bonds, and other types of investments;
- A second car or truck;
- A second or vacation home.

Examples of exempt property that a debtor may retain may include:

- A motor vehicle, up to a certain value (up to $4,000 in a car or motorcycle);
- Reasonably necessary clothing;
- Reasonably necessary household goods and furnishings ($13,400 total in household goods (furnishings, appliances, bedding, clothing, garden tools, and the like, with a cap of $625 per item);
- Household appliances;
- Jewelry, up to a certain value ($1,700);
- Certain pensions (up to $1 million dollars).(Certain pensions are completely exempted; for example, any retirement funds that are tax exempt under the U.S. Tax Code, such as 401, 403 or 408 plans, any pension or retirement funds that qualify under ERISA, certain government retirement plans, deferred compensation plans, any retirement plan provided to a "controlled group" such as churches, partnerships, proprietorships or governments, and any retirement plan established and maintained by a tax-exempt organization);
- A portion of equity in the debtor's home ($23,675 federal exemption. (However, in order to use a state's homestead exemption, the debtor must have acquired his or her home in the state where he or she currently lives within 40 months prior to filing for bankruptcy. Otherwise, the homestead exemption is capped at $170,350 ($160,375 for cases filed between April 1, 2016, and March 31, 2019). This cap doesn't apply if the debtor bought his or her home with the proceeds from selling another home in that state.);
- Tools of the debtor's trade or profession, up to a certain value ($2,525);
- A portion of unpaid but earned wages;
- Public benefits, including public assistance (welfare), social security, and unemployment compensation, accumulated in a bank account;
- Damages awarded for personal injury (up to $25,150).

There are also both state and federal exemptions, "popularly known as the 'wild card' exemption, [which] helps achieve the fresh start goal. Primarily, the 'wild card' prevents discrimination against those debtors possessing little or no homestead from which they may otherwise claim as exempt property" (*In re Austin*, 1987, p. 78.)

5.3. The Federal Bankruptcy Wildcard Exemption **(Geller, 2018; O'Neill, 2020b)**

As of April 1, 2019, the federal wildcard exemption amount is $1,325, and $12,575 of unused residential property exemption ($1,250 and $11,850 respectively for cases filed between April 1, 2016, and March 31, 2018).

These amounts can be applied to any property. However, that a debtor can only use the federal bankruptcy wildcard exemptions if the debtor's state provides him or her with that choice.

5.4. The State "Wild Card" Exemption

If the debtor's state has adopted a "wildcard exemption," the debtor can apply it to otherwise non-exempt property. For example, a debtor has an accordion worth $2,000 that he or she wants to keep but the debtor's state doesn't provide an exemption for musical instruments. However, the debtor does have a $5,000 wildcard exemption. The debtor could apply $2,000 of that wildcard exemption to the accordion and keep it. The debtor would then have $3,000 left to apply to other property.

The debtor can also add the wildcard exemption to an existing exemption; for example, if the debtor has a car worth $5,000 and the debtor's state's motor vehicle exemption is only $3,500. If the debtor's state has a $2,000 wildcard exemption, the debtor could apply $1,500 of it to his or her motor vehicle and keep it since the entire car would now be exempt.

Some states allow the debtor to use the wildcard exemption for any type of property. Other states specify the property in which it can be used. For instance, some states permit the debtor to apply the wildcard to personal property only.

6. Alternatives to Chapter 7

Debtors should be aware that there are several non-bankruptcy alternatives to Chapter 7. Debtors can enter into out-of-court agreements with creditors (called "composition with creditors" agreements) or a debtor may seek debt counseling services as an alternative to a bankruptcy filing. In *Burlington-Rock Island Railroad v. United States* (1963, p. 820), the United States Court of Appeals for the Fifth Circuit stated:

> "A composition with creditors in an agreement between a debtor and two or more of his creditors… whereby the creditors agree to accept in full satisfaction something different from or less than that which they originally claim…. It is most commonly a bilateral contract whereby the debtor promises to render the substituted performance and the creditors promise to receive it in full satisfaction. Such a composition agreement is an accord executory, resulting in a satisfaction and discharge of the original claims only when the new performance is rendered. After it is made, however, unless the contrary is clearly agreed on, it operates as a suspension of the original claims as long as the debtor has committed no material breach of it. It is an enforceable contract, so that either the debtor or the creditors can maintain action thereon in case of breach by the other party."

These alternatives are especially encouraged under current bankruptcy law!

Debtors who are engaged in business, including corporations, partnerships, and sole proprietorships, may prefer to remain in business and avoid liquidation. Such debtors should consider filing a petition under Chapter 11 of the Bankruptcy Code. Under Chapter 11, the debtor may seek an *adjustment of debts*, either by reducing the debt, by extending the time for repayment, or the debtor may seek a more comprehensive reorganization.

6.1. Chapter 11: Business or Commercial Reorganization

Chapter 11 is ordinarily selected by commercial enterprises that desire to continue operating a business ("debtor in possession") (Shachmurove, 2019) under Section 363 and repay creditors concurrently through a court-approved plan of reorganization. The Third Circuit Court of Appeals in *In re Roth* (1992, p. 952, note 42) noted: "The framework of section 363 is designed to allow a trustee (or debtor-in-possession) the flexibility to engage in ordinary transactions without unnecessary creditor and bankruptcy court oversight, while protecting creditors by giving them an opportunity to be heard when transactions are not ordinary."

Under Chapter 11, the debtor usually has the exclusive right to file a *plan of reorganization* for the first 120 days after it files the bankruptcy case (*Gaines v. Perkins*, 1987; *In re Cwnevada LLC*, 2019) and must provide creditors with a disclosure statement containing financial information sufficient to enable creditors to evaluate the plan (*Concannon v. Constantini*, 1996; see also Lubben, 2019, Chapter 11). The bankruptcy court ultimately must approve (confirm) or disapprove the plan of reorganization.

Under a confirmed plan, the debtor can reduce its debts by repaying a portion of its obligations and discharging others. As a distinct advantage to a debtor, the debtor can also terminate burdensome contracts and leases (*Top Rank, Inc. v. Ortiz*, 2009), recover assets, and repurpose its operations in order to return to profitability. As a result, under Chapter 11, the debtor normally goes through a period of consolidation or reorganization and emerges with a reduced debt load and a restructured business.

6.2. Chapter 13: Adjustment of Debts of an Individual with Regular Income

Individual debtors who have regular income may seek an *adjustment of debts* under Chapter 13 of the Bankruptcy Code (Eraslan, Kosar, Li, & Sarte, 2016; e.g., *McDonald v. Chambers*, 2020). For example, a particular advantage of Chapter 13 is that it provides an individual debtor with an opportunity to save their homes (or other property) from foreclosure by allowing them to "catch up" past due payments through a payment plan.

Chapter 13 may be a preferable option because it allows the debtor to propose a "plan" to repay creditors over time– usually three to five years. Chapter 13 is also used by a debtor who does not qualify for Chapter 7 relief under the means test.

The court either approves or disapproves the debtor's repayment plan at the confirmation hearing (see *Bennett v. Springleaf Financial Services*, 2012), depending on whether it meets the Bankruptcy Code's requirements for confirmation. Under Chapter 13, the debtor may remain in possession of the property of the estate and makes payments to creditors through the trustee, based on the debtor's anticipated income over the life of the plan.

Unlike Chapter 7, the debtor will *not* receive an immediate discharge of debts. The debtor must complete the payments required under the plan before the discharge is received. However, the debtor is protected in the interim from lawsuits, garnishments, and other creditor actions while the plan is in effect.

7. Revoking the Discharge

The court may revoke a discharge under certain circumstances (*Weil v. Elliott*, 2017; *Medley v. Dish Network, LLC,* 2020). For example, a creditor or the U.S. trustee may request that the court revoke the debtor's discharge in a Chapter 7 case based on allegations that the debtor:

- Obtained the discharge fraudulently;
- Failed to disclose the fact that he or she acquired or became entitled to acquire property that would constitute property of the bankruptcy estate;
- Committed one of several acts of impropriety described in section 727(a)(6) of the Bankruptcy Code (*Shinn v. Harmon*, 2007); or
- Failed to explain any misstatements discovered in an audit of the case or fails to provide documents or information requested in an audit of the case (United States Courts, 2020).

Typically, a demand to revoke the debtor's discharge must be filed within one year of the discharge or, in some cases, before the date that the case is closed. The bankruptcy court will decide whether such allegations are true and, if so, whether to revoke the discharge.

8. The Order of Payment in a Business Bankruptcy

First priority for debt repayment usually will be accorded to persons who become creditors *after* the company files for bankruptcy if the claims arose "in the ordinary course of the debtor's business or financial affairs" (see *In re Lappin Electric Company*, 2002). These are sometimes called "gap creditors" (Mullin, 1994). The purpose of this rule is to enable the company to borrow sufficient funds in order to continue its operations and/or to effectively wind down its affairs. The order of repayment is as follows:

- **Secured creditors:** In a Chapter 11 bankruptcy, secured creditors are paid first, sometimes partially through the return of the property.
- **General (unsecured) creditors:** General creditors include suppliers of goods and services, and other lenders and bondholders.

  The Eleventh Circuit distinguished between secured and unsecured creditors and noted in *SEC v. Wells Fargo Bank, NA.* (2017, p. 1344):

  > "In the bankruptcy context, a secured creditor's lien remains intact through the bankruptcy, regardless of whether the creditor files a proof of claim…. 'An unsecured creditor is required to file a proof [of] claim for its claim to be allowed, but filing is not mandatory for a secured creditor. In fact, a secured creditor need not do anything during the course of the bankruptcy proceeding because it will always be able to look to the underlying collateral to satisfy its lien.'"

- **Stockholders** are last in line in terms of a business bankruptcy. As owners of the company, shareholders take a greater risk than secured and general creditors (see e.g., *Dish Network Corporation v. DBSD North America, Inc.*, 2011; *In re Eastman Kodak Company*, 2012).

9. Concluding Comments

In this two-part series focusing on rights of creditors and debtors, the authors have delineated the major strategies available to debtors facing a crushing burden of debt and to creditors who have extended credit in a variety of circumstances. In addition, the article points out the protections available to creditors who have extended credit to a variety of individual and business debtors.

These two articles indicate efforts to achieve a balance between the rights of creditors and debtors through a careful application of both Article 9 of the Uniform Commercial Code and the Bankruptcy Code—especially in times of economic stress.

TABLE 1

	CHAPTER 7	CH. 11	CH.13	CHAPTER 7 %
2010	1,100,116	1,939	434,739	71.58%
2011	958,634	1,757	402,454	70.34%
2012	816,271	1,461	363,280	69.12%
2013	706,499	1,320	330,899	68.02%
2014	600,885	1,141	307,783	66.04%
2015	519,130	1,111	299,515	63.33%
2016	475,332	1,118	294,396	61.66%
2017	472,190	1,092	292,581	61.65%
2018	461,897	1,017	288,272	61.49%
Year	**Chapter 7**	**Chapter 11**	**Chapter 13**	**Chapter 7 percentage**

Source: The Ascent (2020). Personal Bankruptcy Statistics for 2020. *The Ascent* (March 24, 2020). Available: **https://www.fool.com/the-ascent/research/personal-bankruptcy-statistics/**

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