

Introduction to Consumer Chapter 7 and Chapter 13 Bankruptcy

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I. OVERVIEW

A. Purpose

The purpose of bankruptcy is to give honest debtors a fresh start. To this end, it is critical that Debtors and their counsel reasonably investigate their financial affairs and accurately complete and file the schedules and related documents required under that particular Chapter of the Bankruptcy Code.

B. Reasons for filing. Bankruptcy is and should be the last resort, but the last resort often arrives more quickly than many people realize.

1. We generally do not receive a good financial education. As a result many people do not have a good sense of their expenses, and do not have a household budget.
2. Many people do not have a good sense on how much they owe and often underestimate the requirements to actually pay off their debts.
3. Most people live paycheck to paycheck, with little or no reserves set aside for emergencies.

4. As a result, when a cataclysm strikes, such as job loss, illness or divorce – or even when it does not – people can quickly become overwhelmed and need to file bankruptcy

C. Pre-filing Credit Counseling and Debtor Financial Education Courses

Debtors must complete a pre-filing credit counseling course before filing the case. After filing the case, but before being eligible for a discharge, a debtor must complete a second financial education course.

Information about these courses is available at the UST's website at

[justice.gov/ust/credit-counseling-debtor-education-information](https://www.justice.gov/ust/credit-counseling-debtor-education-information).

c. Practicalities of filing bankruptcy cases

Bankruptcy practice, as with most fields of law, has become more and more specialized, with increasing technical requirements for both creditors and debtors. Relevant forms continually increase in number and complication. It is now almost impossible to efficiently and effectively represent Debtors without the aid of bankruptcy case preparation software (which grows increasingly more expensive).

II. CHAPTER 7

A. Overview: This is the most common type of bankruptcy case. Debtors initiate a Chapter 7 case by filing a petition and supporting documents (schedules, statement of financial affairs and other ancillary documents). Upon the filing of the case, a Chapter 7 bankruptcy trustee is randomly assigned from a panel of trustees maintained by the Office of the U.S. Trustee to administer the case. Among other duties, the Chapter 7 Trustee reviews the schedules filed by the debtor for accuracy and potential Estate assets, examines the debtor at the first meeting of creditors (also known as the 341 meeting), which usually occurs about 30-45 days after the filing of the case, and at times investigates the Debtor's eligibility for Chapter 7 relief and for a Chapter 7 discharge. Chapter 7 cases are "liquidations (although there is rarely anything to liquidate)" – Debtors do not make payments to creditors.

B. The Automatic Stay provided by §362 immediately stays almost all collection efforts against the Debtors, with notable exceptions. The stay continues until the earlier of the close of the case, Debtor's discharge, or the relevant property is no longer property of the estate, whether by Court order or otherwise. §362(c). The automatic stay is part of the critical relief afforded Debtors by the Bankruptcy Code and is an important component of the Debtors' fresh start. Debtors can sue creditors for willful violations of the automatic stay. §362(k).

C. Property of the Estate: The filing of a bankruptcy case creates a bankruptcy estate as of the filing date, which includes “all legal or equitable interests of the Debtors in property as of the commencement of the case,” including all assets, causes of action, and ownership interests in entities. §541(a). Limited exceptions include earnings from post-petition services and assets held in trust pursuant to C.G.S. §52-321a. The estate “extends forward” 180 days from the petition date to include rights received due to an inheritance, property settlements obtained from a divorce, and life insurance proceeds.

D. Exemptions: Debtors are allowed to exempt certain property from the estate, whether under federal exemptions under §522(b)(2) and §522(d) or Connecticut State Exemptions pursuant to §522(b)(3) and §§52-352a and 52-352b. These exemptions differ in critical ways. Put simply, Connecticut exemptions are superior for residences, wedding rings, and tools of the trade, while Federal exemptions are generally superior in all other respects, most importantly cash and cash equivalents. Debtors exempt equity rather than the value of the asset, i.e., the asset's value less the balance of the secured claims on same. Exemption planning is one of Debtors' counsel's most important duties to their clients.

F. Preferences: Pursuant to §547, the Chapter 7 Trustee can pursue causes of action based on preferential payments 90 days prior to bankruptcy filing (or for one year to insiders such as relatives and business partners). These transferees potentially have the defenses set forth in §547(c).

G. Fraudulent Transfers: Pursuant to §548, include transfers made with actual intent to defraud or made while the Debtors were insolvent (or that rendered the Debtors insolvent) within 2 years of the petition date. Trustees can also pursue fraudulent transfers within 4 years of the petition date under Connecticut law under §544 and §52-552 *et seq.*

H. Liens generally pass through a Chapter 7 case unaffected, except for judgment liens, which the Debtor can “avoid” – strip off – depending on whether they impair the Debtors exemption on the property, which generally depends on the equity in the property. §522(f). Otherwise, Debtors must stay current on their consensual and statutory liens, or deal with these creditors outside of the bankruptcy process.

- I. **Unsecured creditors** can have their debt declared nondischargeable – and surviving the bankruptcy - if they have grounds to do so, in two basic categories:
 - a. Pursuant to §523(a)(2), (a)(4), and (a)(6), creditor must bring an action against the Debtors in bankruptcy court by a certain deadline and prove the debt is nondischargeable for grounds including fraud, misrepresentation, false pretense, fraudulent breach of fiduciary duty, embezzlement, larceny, defalcation, and for a willful and malicious injury.

b. Pursuant to the remaining sections of §523(a), the debt is either automatically nondischargeable or Debtor has to sue the creditor and prove debt is dischargeable, which may be difficult or impossible. These types of “automatically” nondischargeable debts include income taxes due and payable for less than three years, domestic support obligations and property settlements owing due to a divorce, student loans (although that may be changing), certain criminal fines, and debts due to drunk driving incidents.

J. Eligibility for Chapter 7 depends on whether Debtors' debts are largely consumer debts, their income level and expenses, and whether Debtor satisfies the §707(b) (2) Chapter 7 means test and §707(b) (3) "abuse" standard. If Debtors are consumer Debtors and their combined income from all sources exceeds the Connecticut median income for that size family, Debtors' case is presumed abusive unless they otherwise qualify for Chapter 7 through deduction of allowed expenses. These latter calculations can become exceedingly complex.

K. Individuals receive a **discharge** at the end of their case discharging them from all dischargeable debt. Pursuant to §524, this is actually a permanent injunction against collection, so these debts technically exist, but are extinguished as a practical matter. A bankruptcy discharge will substantially negatively impact a Debtor's credit rating, and stays on a credit report for 10 years. But by the time Debtors are considering filing bankruptcy their credit is usually fair to poor in any case, and the benefits of bankruptcy usually outweigh any such impacts. Aggressive credit rebuilding can mitigate this impact.

Debtors' counsel needs to be aware of Debtors' previous bankruptcy cases, however, as this relief is limited for Debtors who have previously filed a bankruptcy case and obtained a discharge, depending on the Chapter and filing date. Chapter 7 Debtors do not receive a discharge if they filed a Chapter 7 case (and received a discharge) within 8 years, or if they filed a Chapter 13 case within 6 years and received a discharge.

III. CHAPTER 13

A. **Chapter 13s are individual reorganizations.** Debtors need to file schedules, statement of financial affairs and other related documents just as in a Chapter 7, and must attend a §341 meeting presided over by the Chapter 13 Trustee. Unique to the Chapter 13 is the codebtor stay – creditors are prevented from pursuing any codebtors until the case is closed, dismissed or converted, even though they did not file bankruptcy themselves. §1301.

B. But the focus in a Chapter 13 case is whether Debtors can confirm their Chapter 13 plan, complete payments, and receive their discharge. Debtors must pay into the plan for 3-5 years, and receive their discharge after completing all payments. Debtor's income level determines the minimum plan length – above the median income Debtors must propose a five year plan, while below the median income Debtors can propose a shorter plan.

C. Debtors exceeding the **§109(e) eligibility levels** for secured debt in the amount of \$1,257,850 and unsecured debt in the amount of \$419,2375 do not qualify for Chapter 13 relief. They must either file a Chapter 11 individual reorganization or attempt a “Chapter 20” – first file a Chapter 7, then file a Chapter 13.

D. The primary goal of most Chapter 13 cases is to cure and reinstate defaults on secured debt, usually on the Debtors' residence. Chapter 13 can also be an effective way to pay nondischargeable income taxes, as the Code does not require payment of post-petition interest on these claims, and associated penalties are treated as unsecured claims. Debtors who do not qualify for Chapter 7 relief but need a discharge can also attempt to pursue a Chapter 13 case. The latter cases are challenging because Debtors' plan payments are determined by the Chapter 13 Statement of income, which often requires a payment Debtors cannot afford.

E. Debtors can **avoid and modify liens** on real or personal property pursuant to §506:

1. Debtors can “avoid” liens that are completely unsecured based on the equity in the real or personal property, provided they complete their plan payments and receive their discharge.
2. For rental property, including multifamily properties in which the Debtor resides, or personal property, value of lien can be "stripped" to the property's value, but Debtors must then pay off the resulting balance during the plan term.

3. Debtors can avoid judicial liens under §522(f) just as in Chapter 7 cases.

F. Debtors find Chapter 13 plans difficult to complete for any number of reasons – not enough income to accomplish the primary goal of the plan, loss of and/or inconsistent income, illness, life events. At least 1/2 of all Chapter 13s fail either pre or post confirmation.

IV. PRACTICE POINTERS

- A. As discussed above, it is now effectively impossible to represent Debtors without the aid of Bankruptcy preparation software.
- B. Due to the Bankruptcy processes' emphasis on disclosure, the bankruptcy intake process is critical.
- C. Bankruptcy practice is now very document intensive. Chapter 7 Debtors must send a fair amount of documentation to the Trustee prior to their first meetings of creditors, including bank statements, mortgage statements, tax returns, and proof of value of their real property. In addition, in Chapter 13 cases, Debtors must send certain financial documents to the Chapter 13 Trustee every month.

- D. You will find as a Debtors' bankruptcy attorney that you need to know a little bit about everything in order to be effective, including foreclosure law, real property, corporate law, and family law – to name a few.
- E. Debtor bankruptcy practice is extremely personal. Debtors' attorneys must be able to effectively communicate, sympathize, and empathize in order for their clients to be successful in their cases.