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HELP! SHOULD MY BUSINESS FILE FOR BANKRUPTCY PROTECTION?

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It is July of 2020, and domestic and international news cycles are full of stories of global pandemic, record unemployment, and an uncertain path towards international economic recovery. In light of the extraordinary circumstances being reported, it is important to remember that, in more mundane (or even strong) economic conditions, businesses and individuals have always found it necessary to avail themselves of bankruptcy protections.

Externalities, such as poor market conditions and pandemics, often serve to exacerbate existing financial issues. In fact this May, clothing retailers J.Crew, Neiman Marcus, and J.C. Penney all filed petitions for Chapter 11 Reorganization, after years of struggling sales coupled with store closures from the COVID-19 pandemic. Several other notable retailers have followed. However, internal issues, absent such externalities, are typically the primary drivers of business bankruptcies. A business may suffer from inflexible management or adhere to strategies that prove unsuccessful—the familiar names of department stores and other brick-and-mortar retail giants have graced the news with bankruptcies throughout the past decade. A business may struggle with cashflow, have its access to financing cut off, or it may be overburdened with uneconomical contracts. Assets that could be liquidated to increase cash flow may be encumbered by liens, making those assets unattractive to buyers.

An individual with out-of-control consumer debt may seek bankruptcy protection, but individuals often have substantial triggering events that precipitate a bankruptcy—e.g., the loss of a job, medical difficulties, or even divorce. An individual may be facing a foreclosure or the burdens of personal guaranties on business debts. Finally, both businesses and individuals may find themselves facing mounting litigation and its concordant costs and disorder.

The various forms of bankruptcy—the different chapters of the Bankruptcy Code—provide debtors with mechanisms to restructure payments to creditors, reamortize or refinance debts, and in some instances discharge liabilities. Bankruptcy can also provide means of “cramming down” a secured creditor’s security interest to the value of collateral as well as rejecting uneconomic contracts or leases—avoiding deficiency judgments that would otherwise result when a sale of collateral, outside bankruptcy, fails to satisfy the full amount of debt owed. Assets encumbered by liens can be sold free and clear of existing liens and interests, making those assets more attractive to third parties. Finally, but perhaps most vitally, bankruptcy generally provides an automatic stay against (i.e., a breathing spell from) pending litigation, foreclosure,

repossession, or collections efforts, forcing those legal actions or collections efforts into a centralized bankruptcy administration.

Bankruptcy is by no means a remedy for all the above problems, but it can afford a business or an individual the opportunity to correct a struggling course. There are associated costs to pursuing a bankruptcy case, and certain chapters are more expensive than others. Transparency before a bankruptcy court and various officials, such as trustees and administrators, is essential to obtaining a positive outcome. Pre-bankruptcy transfers of assets must be disclosed, and depending on the chapter, a debtor will be accountable for every dollar earned and disposed for the pendency of their case. On that note, bankruptcy cases are rarely quick proceedings; many last several years with monthly hearings, if not more often.

There are also intangible concerns of reputation and creditworthiness. A business that is in or has recently emerged from a bankruptcy case may be viewed with skepticism by vendors from which that business may seek credit and even the general public. Closing locations and laying off employees, which may occur during public bankruptcy proceedings, will almost certainly cause the public image of a business to decline. An individual's credit report will reflect their bankruptcy case for a number of years. However, if the costs, scrutiny, time, and reputational concerns are outweighed by the necessity and benefits of a bankruptcy case, it may be one of the best possible options available to a business or individual facing difficulties.

Bankruptcy is not the only option available to those who are struggling. A debtor may opt to allow a foreclosure to occur if the collateral is not a necessity. Financed equipment or vehicles may be repossessed. A state or federal court can enter a receivership order allowing a third party to manage the assets of a struggling business. A putative debtor could assign its assets for the benefit of creditors in a state court proceeding. Finally, a debtor can seek an out-of-court liquidation of its assets or, if it has sufficient leverage, other means of negotiating or restructuring debts.

Other factors, relevant to the administration of bankruptcy proceedings, may make bankruptcy unattractive. Creditors may have liens on accounts and other receivables, i.e., the business's operating funds and, in bankruptcy jargon, "cash collateral." Upon the filing of a bankruptcy case, a debtor cannot use cash collateral without a court order for any purpose, including making payroll or payments in the ordinary course of business. If a business (or an attorney advising a business) is not prepared to resolve cash collateral issues before employees or critical vendors must be paid, the medicine of bankruptcy may prove to be worse than the diagnosis.

Also, a debtor in bankruptcy, or a trustee appointed under certain chapters of the Bankruptcy Code, has a duty to investigate transfers of property prior to the bankruptcy filing. Transfers to business insiders, family members, and other associates; payments to creditors prior to the case; and transfers made as part of an asset protection strategy may all be vulnerable to avoidance actions in the Bankruptcy Court. It is not uncommon for trustees to pursue litigation against the directors, officers, or management of a business. Every transaction during a bankruptcy case should be presumed to be scrutinized.

Non-bankruptcy options may not be available to every business or individual, and certain conditions may render bankruptcy the best—or only—available option. Aggressive collections activities or pending litigation may force a debtor’s hand. Vendors may refuse to ship inventory. An onslaught of litigation, such as the California wildfire liability actions filed against Pacific Gas & Electric Company in recent years, can render non-bankruptcy options insufficient for addressing a plethora of newly-founded, and unliquidated, claims. Creditors may simply refuse to cooperate with voluntary out-of-court workouts or assignments for the benefit of creditors.

Determining whether a business or individual would be best suited by seeking the protections of the Bankruptcy Code is just the tip of the iceberg. The goals of the business or individual filing for bankruptcy protection, as well as the nature of their finances, dictate the chapter or chapters under which that debtor may be eligible for bankruptcy relief, and of those chapters, which chapter would be most beneficial. Certain entities, such as trusts and probate estates, are not eligible for bankruptcy relief. Generally, any individual person is eligible for relief under the Bankruptcy Code, as are corporations, limited liability companies, partnerships, and sole proprietorships.

Bankruptcy takes two primary forms: liquidation or reorganization. Liquidation is available to practically any person or business under Chapter 7 of the Bankruptcy Code. In Chapter 7 bankruptcy, a court-appointed trustee liquidates the assets of a debtor existing at the time of the bankruptcy filing, pays the value of those assets to creditors, and, to the extent provided for in the Bankruptcy Code, discharges the debtor of further liability. Chapter 13 bankruptcy is a form of reorganization aimed at individuals and sole proprietorships with debts below a statutory limit, wherein the debtor tenders court-approved payments, through a trustee, to creditors in exchange for a discharge. Chapter 12 is a special form of bankruptcy for fishermen and farmers with debts below a certain amount combining features of Chapter 13 with certain components of Chapter 11.

Chapter 11 is the prototypical business reorganization, though it is also available to individuals. There are no debt limits for Chapter 11—the debtor must simply be eligible for relief under the Bankruptcy Code. There are instances, however, where a Chapter 11 is essentially a liquidation of assets (often in sales intended to strip liens and interests that would follow the assets outside of bankruptcy) and winding down of affairs, tantamount to a Chapter 7 without an appointed trustee. Chapter 11 also includes the new subsection “Subchapter 5,” which provides for streamlined treatment of “small business” reorganizations for businesses with debts below a certain amount.

The CARES Act, the COVID-19 stimulus bill recently passed in response to the current pandemic, contained several amendments to the Bankruptcy Code. The debt limit for small business Subchapter 5 debtors was increased almost threefold to \$7.5 million. The CARES Act amendments also provide that stimulus payments to individuals are not to be included in the “disposable income” parameters of Chapter 13 plans, that Chapter 13 plans may be modified due to COVID-19-related hardship, and that Chapter 13 plans may be extended up to seven years.

The temporary amendments of the CARES Act expire in the next year, but any person considering the relevance of bankruptcy relief to their given situation should be mindful of future amendments or acts of Congress arising from the current pandemic.

WHAT TYPE OF BANKRUPTCY SHOULD MY BUSINESS FILE?

Although Chapter 11 bankruptcy is the prototypical bankruptcy associated with businesses, it is not a one-size-fits-all solution for all business owners. The type of bankruptcy that a business should file depends on many factors from the type of business, the type of business debt, the type of assets, and whether the business intends to keep operating or to liquidate.

Depending on eligibility requirements, a business may be able to file for Chapter 7, Chapter 11, Chapter 12, or Chapter 13 Bankruptcy.

- Although associated with businesses, individuals may also file for Chapter 11 relief. This can be particularly useful when an individual is part of a single member LLC and/or an LLC with a domestic partner or family member and the business assets are such that they are not so distinct from the owner/debtors. Chapter 11 relief is usually associated with businesses because there are no debt thresholds as there are in Chapter 13 outlined below. Also, Chapter 11 allows the debtor to be debtor-in-possession of the business assets, so the business may continue to operate during the bankruptcy process. This is why J.Crew and Neiman Marcus are flooding email inboxes with news of sales. Both companies still have stores and warehouses full of inventory that they want to sell while they work to create a plan of reorganization to negotiate with their creditors. This will be explained in more detail below.
- Subchapter V relief, or small business bankruptcy, is for debtors “engaged in business activities.” In this subsection of Chapter 11, the debtor operates a business and its primary activity must not be the business of owning single asset real estate. A Subchapter V debtor must have combined secured and unsecured debts (excluding insider debts) of no more than \$2,725,625; however, the CARES Act raised the debt limit to \$7,500,000 until March 27, 2021. Also, more than fifty percent of those debts must have arisen from the debtor’s business activities.
- Chapter 12 is a type of bankruptcy unfamiliar to many individuals, but it is one type of bankruptcy relief immensely helpful to many North Carolinians. Chapter 12 relief is designed specifically for “family farmers” or “family fishermen” with “regular annual income,” as defined in the Bankruptcy Code. It allows financially distressed family farmers and fishermen to negotiate and carry out a plan to repay all or a portion of their debts. Like Chapter 13 and Chapter 11, the debtors in a Chapter 12 propose a repayment plan to make installments to creditors, typically over three to five years. However, like Chapter 13, there are specific requirements, to be outlined below, determining whether a business may file for Chapter 12 relief.
- Individuals and sole proprietorships may qualify for Chapter 13. Corporations, limited liability companies, and partnerships are not eligible to file for Chapter 13 Bankruptcy protection. However, in this era of increased freelance work and 1099 contracting work, a Chapter 13 may be attractive for an unincorporated business or for those individuals who

are self-employed. An individual is eligible for Chapter 13 relief so long as that individual's unsecured debts are less than \$419, 275 and that individual's secured debts are less than \$1,257,850.

- Although numerically first, Chapter 7 relief is saved for last. As mentioned, practically anyone, both human or non-human entity, may file for Chapter 7 relief. In a Chapter 7 bankruptcy, the individual or the business no longer retains control over the debtor's assets. Instead, the Court appoints a trustee. That trustee gathers and sells all the debtor's assets as part of the "bankruptcy estate" to pay the claims of the debtor's creditors. Chapter 7 bankruptcy may be useful for a business with a large number of tangible assets such as equipment or real property that may hold value at a liquidation sale.

CHAPTER 11 – REORGANIZATION FOR INDIVIDUALS AND BUSINESSES

As mentioned above, both corporations and individuals may file for relief under Chapter 11. The process starts with the filing of the petition. The petition includes such information as the debtor's name or names, social security number or tax identification number (if a business), residence, location of principal assets (if a business), and a request for relief under the appropriate chapter of the Bankruptcy Code. The Court requires a \$1,167 filing fee and a \$550 miscellaneous administration fee to file the petition. A debtor may pay the \$1,167 filing fee in installments, but such installments must be completed within 120 days of filing the petition. It is recommended that most business debtors pay these fees up front and many bankruptcy attorneys will require such as part of a retainer. Once the petition is filed, the debtor becomes a "debtor in possession." Instead of the Court appointing a trustee as in Chapters 12, 13, and 7 discussed below, as "debtor in possession" the debtor has fiduciary obligations to the Court and to its creditors throughout the bankruptcy process. However, doing this allows the business to keep operating. Again, this is why retailers like J.Crew, Neiman Marcus, and J.C. Penney are still operating stores, mostly business as usual, despite filing for bankruptcy.

Debtor-In-Possession

The debtor in possession has additional duties besides keeping its business operational. Those duties are outlined in more detail in the Bankruptcy Code. However, generally those duties include accounting for property, examining and objecting to the claims of creditors, and filing monthly operating reports as required by the court and the bankruptcy administrator. Managing these requirements is difficult and require debtors to have a good handle on the financial health of their businesses. For this reason, it is recommended that debtors employ accountants and/or financial advisors as well as legal counsel to navigate the process.

The Automatic Stay

Besides the term debtor-in-possession, the term automatic stay is one of the key principles of Chapter 11 relief (and bankruptcy relief more generally). The automatic stay lives up to its name and for a period of time it automatically places a pause on any judgments, collection activities, foreclosures, and repossessions of property by the debtor's creditors for any debt or claim that arose before the filing of the bankruptcy petition. The automatic stay goes into effect when the bankruptcy petition is filed. The goal of the stay is to provide short-term relief for the debtor,

during which negotiations can take place between the debtor and its creditors to try and resolve certain problematic aspects of the debtor's financial situation. However, a secured creditor may be able to obtain "relief from the automatic stay" by filing a motion showing that specific secured property has no equity and is not necessary for the debtor's effective reorganization. This commonly occurs with tangible assets of the debtor that may have little equity but some fair market value for which the creditor could sell the asset on the open market.

Creditors and Claims

One distinction of Chapter 11 bankruptcy cases is the unsecured creditors committee. The committee is appointed by the bankruptcy administrator (in North Carolina) and typically is comprised of the unsecured creditors who hold the seven largest unsecured claims against the debtor. This brings up the issue of claims. The Bankruptcy Code defines a claim as: (1) a right to payment; or (2) a right to an equitable remedy for a failure of performance if the breach gives rise to a right to payment. Generally, the debtor files a list of known claims, i.e., all the debts, judgments, liabilities, etc. on its schedule in the petition. If a creditor finds that its claim is not listed on the debtor's schedules, or the debtor's schedules are disputed, then the creditor must file a proof of claim, along with evidence documenting that claim; these steps are necessary for the creditor to be treated as a creditor for purposes of voting on the plan and distribution under the plan. This will be discussed more below. However, filing a proof of claim is not necessary if the creditor's claim is listed on the schedules as undisputed because the debtor's schedules are deemed to constitute evidence of the validity and amount of those claims.

The Plan and Disclosure Statement

The debtor has a 120-day period during which it has an exclusive right to file a plan. The Bankruptcy Code outlines the mandatory and discretionary provisions of a plan, but a plan must designate classes of claims and interests for treatment under the reorganization. Typically, claims are divided into classes based on the type of debt owed, such as taxes (federal, state, and local), secured debt, and unsecured debt, and even within those by creditors who may be fully secured or only partially secured. Along with the plan, the debtor must file a disclosure statement. This statement gives the creditors and the Court an outline of the financial affairs of the debtor and the proposed treatment for the creditors as part of the plan. Typical items included are budgets, projections, lists of assets along with the valuations of those assets, and any other documents supporting the plan of reorganization.

The filing of the plan does not mean that it will be confirmed by the court or accepted by the debtor's creditors. Any party in interest may file an objection to the debtor's proposed plan. Any objections to the plan's confirmation will be heard at the confirmation hearing; however, in the absence of an objection, the Court must still determine that the plan was filed in good faith and otherwise complies with the Bankruptcy Code. Among other requirements, the plan must be 1) feasible, 2) filed in good faith, 3) meet the best interest of creditors test, and 4) meet the absolute priority rule.

- For a plan to be feasible, the Court must find that it is not going to require the debtor to liquidate the business (unless the plan is a plan for the liquidation of assets) or be followed by further financial reorganization.

- The good faith requirement typically has been interpreted to require that a plan be proposed with honesty, good intentions, and some basis for expecting that a reorganization or liquidation can be accomplished.
- The best interest of the creditors test references Chapter 7, in that the creditors under a Chapter 11 plan must receive at least as much under the proposed plan as those creditors would receive under liquidation in a Chapter 7 bankruptcy. This is where the unsecured creditor committee can become important and unique to Chapter 11 cases. Often in Chapter 7 cases, the unsecured creditors are left with essentially nothing, even after the debtor's assets are liquidated. If a Chapter 11 plan calls for making payments to the unsecured creditors, it is potentially going to provide more to these creditors than if the case were a Chapter 7 case. For this reason, the committee often votes in favor of the plan in hopes that the business can keep operating. In the case of J.Crew, this may be the company's silk or wool provider. Such a creditor wants J.Crew to stay in business because it will keep making money by selling its textiles but also receiving plan payments.
- The absolute priority rule requires that the plan be "fair and equitable" to creditors. Under the absolute priority rule, a class of creditors that voted to reject the plan must receive payment in full or no class of creditors below them (i.e., of a lower priority) may receive any payment at all.

Finally, once the plan is confirmed, the debtor is required to make plan payments and is bound by the provisions of the plan of reorganization. The confirmed plan is a binding contract between both the debtor and the creditors, creating new contractual rights, which replace or supersede pre-bankruptcy contracts and debts. For non-individual debtors, generally confirmation of a plan discharges a debtor from any debt that arose before the date of confirmation.

SMALL BUSINESS CHAPTER 11 OR SUBCHAPTER V BANKRUPTCY

In February of 2020, new provisions of the United States Bankruptcy Code went into effect aimed at providing relief for small businesses. Like a Chapter 13 bankruptcy, and unlike the rest of Chapter 11, bankruptcy relief under Subchapter V does have debt requirements. The secured and unsecured debts of the debtor must be less than \$2,725,625 (increased to \$7,500,000 until March 27, 2021 under the CARES Act) and fifty percent of those debts must come from business activities, excluding debts to affiliates and insiders.

How does Subchapter V differ from Chapter 11?

Unlike in standard Chapter 11 cases, there is no creditors committee. Instead, a status conference is mandatory within 60 days of the petition date. Here, the trustee evaluates the debtor's viability, asks about the debtor's business plan, and explains certain debtor obligations, including the debtor's responsibility to file various reports. Another main difference is the appointment of a trustee. A trustee is appointed in all Subchapter V cases.

Next, the plan must be filed within 90 days of the petition date. However, the Court may extend this deadline if the need for the extension is attributable to circumstances for which the debtor should not justly be held accountable. In a regular small business case, the plan must be filed

within 300 days of petition date but must be confirmed within 45 days of plan filing. Also, only the debtor may file the plan. In a regular Chapter 11, if the debtor does not file a plan within the exclusive 120-day period, the creditors may file a proposed plan. This ability by the creditors is absent from Subchapter V. Additionally, the disclosure statement requires less of the debtor and need only include 1) a brief history of the debtor's business operations, 2) a liquidation analysis, and 3) projections demonstrating the debtor's ability to make the proposed plan payments.

As stated, a trustee is appointed in all cases. However, unlike other trustees in Chapter 7 or 13, a Subchapter V trustee has the duty to facilitate development of a consensual plan. If a consensual plan is developed, then the trustee's services terminate at substantial consummation of that plan. If the plan is a cramdown plan, meaning that it is not consensual, then the trustee is charged with making the plan payments to the debtor's creditors.

Subchapter V also includes additional reporting requirements for the debtor in possession. For example, within 14 days of the initial status conference, the debtor must file a report that details efforts it has undertaken and will undertake to attain a consensual plan of reorganization.

Lastly, if the plan proposes to cramdown or alter the rights of secured creditors, then the plan may be allowed even if every class of creditor rejects the plan. Moreover, there is no absolute priority rule. However, the debtor must pay projected disposable income (or equivalent amount of property) into a plan that lasts three to five years, and appropriate remedies must be included in the plan if payments are not made. As a result, the debtor does not necessarily receive discharge at confirmation as is typical of Chapter 11. The debtor receives a discharge only after completion of all plan payments unless the creditors consent. If all creditors consent, then the debtor can receive discharge at confirmation.

CHAPTER 12 – FAMILY FARMERS AND FAMILY FISHERMEN BANKRUPTCY

Chapter 12 is somewhat similar to the new Subchapter V business bankruptcy in that it is intended to be less complex than regular Chapter 11. Under Chapter 12, only a family farmer or family fisherman with "regular annual income" may file a petition.

Family farmers and family fishermen

"Family farmers" and "family fishermen" fall into one of two categories: 1) an individual or individual and spouse and 2) a corporation or partnership.

- Individuals or individuals and their spouses must 1) be engaged in a farming operation or a commercial fishing operation; 2) must not have total debts (secured and unsecured) exceeding \$10,000,000 (if a farming operation) or \$2,044,225 (if a commercial fishing operation). Additionally, for farmers, at least 50%, and for fishermen, at least 80%, of the total debts that are fixed in amount must be related to the farming or commercial fishing operation and more than half of the gross income of the individual or the husband and wife for the preceding tax year (or, for family farmers only, for each of the second and third prior tax years) must have come from the farming or commercial fishing operation.

- A corporation or partnership must meet each of the following criteria as of the date of the filing of the petition to qualify for Chapter 12 relief: 1) more than one-half the outstanding stock or equity in the corporation or partnership must be owned by one family or by one family and its relatives; 2) the family or the family and its relatives must conduct or manage the farming or commercial fishing operation; 3) more than 80% of the value of the corporate or partnership assets must be related to the farming or fishing operation; 4) the total indebtedness of the corporation or partnership must not exceed \$10 million (if a farming operation) or \$2,044,225 (if a commercial fishing operation); 5) for a farming operation, at least 50%, or for a fishing operation, at least 80%, of the corporation's or partnership's total debts that are fixed in amount must be related to the farming or fishing operation; and 6) the corporation must not have publicly traded stock.

As in Chapter 13, the debtor may not file for Chapter 12 relief if in the immediately preceding 180 days the debtor filed a petition for relief and that petition was dismissed for the debtor's willful failure to appear before the Court or comply with orders of the Court or was voluntarily dismissed after creditors sought relief from the Court to recover property upon which they held liens.

How does Chapter 12 work and how does it differ from Chapter 11?

Among other things, the debtor files its petition; a statement of its financial affairs; a list of all its creditors and the amounts and nature of their claims; the source, amount, and frequency of the debtor's income; a list of all of the debtor's property; and a detailed list of the debtor's monthly farming and living expenses, i.e., food, shelter, utilities, taxes, transportation, medicine, feed, fertilizer, etc. The Court then appoints a standing panel trustee, typically the same trustee in each region for all Chapter 12 cases. However, like Chapter 11, and unlike Chapter 7, the debtor continues to operate the farm or fishing operation.

As in Chapter 11, the automatic stay immediately goes into effect upon filing the petition. However, in Chapter 12 bankruptcy, the stay includes a special provision that protects co-debtors. Under this provision, a creditor may not seek to collect a "consumer debt" from any individual who is liable with the debtor, unless the Court orders otherwise. Consumer debts are those incurred by an individual primarily for a personal, family, or household use.

Also, like Subchapter V, there is no creditors committee. The debtor must file a plan with the petition or within 90 days of filing the petition, but no disclosure statement is required. The plan is a repayment plan that contemplates the debtor will make fixed payments over the next three to five years. Those payments are most often made to the trustee, and then the trustee pays the debtors' creditors according to the terms of the plan. Typically, the plan does not pay creditors in full. Instead, secured creditors must be paid at least as much as the value of the collateral pledged for the debt and unsecured claims need not be paid in full, so long as the plan commits all of the debtor's projected "disposable income" to plan payments over a three to five year period, and so long as the creditors receive at least as much under the proposed plan as those creditors would receive under liquidation in a Chapter 7.

Once the plan is confirmed, the debtor must make the plan payments to the trustee and the debtor may not incur any significant new debt without consulting the trustee. Failure to make the plan payments as well as any failure or act that would compromise the ability of the debtor to make the payments may result in the dismissal of the case. As a result, discharge does not occur until after the plan payments are completed.

CHAPTER 13 – INDIVIDUAL OR CONSUMER BANKRUPTCY

As mentioned, Chapter 13 does not apply to LLCs, partnerships, or corporations. An individual is eligible for Chapter 13 relief so long as that individual's unsecured debts are less than \$419,275 and that individual's secured debts are less than \$1,257,850. However, the debtor may not file for Chapter 13 relief if in the immediately preceding 180 days the debtor filed a petition for relief and that petition was dismissed for the debtor's willful failure to appear before the Court or comply with orders of the Court or was voluntarily dismissed after creditors sought relief from the Court to recover property upon which they held liens.

As in all other cases, Chapter 13 relief begins by filing a petition. The debtor also files, among other things, 1) schedules of assets and liabilities; 2) a schedule of current income and expenditures; 3) a schedule of executory contracts and unexpired leases; and 4) a statement of financial affairs. As do individual debtors in every type of bankruptcy case, the Chapter 13 debtor must file a certificate of completion of credit counseling and a copy of any debt repayment plan developed through credit counseling. Also like other debtors, the Chapter 13 debtor is required to provide the trustee with tax returns and a record of any interest the debtor has in federal or state qualified education or tuition accounts. Again, the operative word is trustee. Like Chapter 12, the Court appoints a standing panel trustee, typically the same trustee in each region for all Chapter 13 cases. Unique to Chapter 13 is the requirement that debtors provide 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.

The filing fee is \$235, and there is a \$75 miscellaneous administrative fee. Usually these are paid upon filing or paid to the attorney as in Chapter 11, but these fees may be made in installments. Again, as in Chapter 11, the final payment must be made within 120 days of filing the petition.

As in Chapter 12, the Chapter 13 trustee both evaluates the case and serves as a disbursing agent, collecting payments from the debtor and making distributions to creditors in accordance with a plan. There is an automatic stay provision that immediately stays most collection actions against the debtor or the debtor's property. This stay also protects co-debtors. Under this provision, a creditor may not seek to collect a "consumer debt" from any individual who is liable with the debtor, unless the Court orders otherwise. Consumer debts are those incurred by an individual primarily for a personal, family, or household use. Often, individuals seek Chapter 13 relief to save their home from foreclosure because, unlike Chapter 7, Chapter 13 permits individual debtors to cure pre-petition arrearages on home mortgages. If a foreclosure action has been commenced, the automatic stay stops the foreclosure proceeding as soon as the individual files

the Chapter 13 petition. This could be potentially useful for the owner of a business debtor who took out a home equity line of credit on his or her home for a business.

The Chapter 13 Plan

The debtor must file a repayment plan with the petition or within 14 days after the petition is filed. Like Chapter 12, this is a fixed repayment plan, and it is submitted for Court approval. The payments are usually frequent, such as biweekly or monthly. The payments are made to the trustee, and then the trustee pays the debtor's creditors according to the terms of the plan. Typically, the plan does not pay creditors in full.

The plan must pay priority and secured claims in full unless a priority or secured creditor agrees to different treatment of the creditor's claim or, in the case of a domestic support obligation, unless the debtor contributes all of the debtor's disposable income to a five-year plan. The plan allows the debtor to keep his or her property such as a house or car, but it must provide that the holder of the secured claim for such property receive at least the value of the collateral during the plan, although there are a few exceptions to this general rule.

Unsecured creditors do not need to be paid in full so long as the plan provides that the debtor will pay all projected disposable income over an applicable commitment period, and so long as the creditors receive at least as much under the proposed plan as those creditors would receive under liquidation in a Chapter 7. Under the Bankruptcy Code, "disposable income" is income (other than child support payments received by the debtor) minus the amounts reasonably necessary for the maintenance or support of the debtor or dependents and minus charitable contributions up to fifteen percent of the debtor's gross income. If the debtor operates a business or is self-employed, then the definition of disposable income excludes those amounts that are necessary for ordinary operating expenses. The "applicable commitment period" depends on the debtor's current monthly income. The applicable commitment period must be 3 years if current monthly income is less than the state median for a family of the same size – and 5 years if the current monthly income is greater than a family of the same size.

Within 45 days after the meeting of creditors, the Court must hold a confirmation hearing and decide whether the plan is feasible and meets the standards for confirmation set forth in the Bankruptcy Code. Creditors may object to the plan, but there is no voting process like in Chapter 11. After confirmation, the trustee then begins distribution of the payments to creditors in accordance with the plan. Obtaining a Chapter 13 discharge is more complicated and more litigated than in Chapters 11, 12, or 7, so the guidance of a competent consumer bankruptcy attorney is required to navigate the process. The Court must make certain findings in addition to the completion of the payments under the plan for the debtor to receive a discharge.

CHAPTER 7 - LIQUIDATION

With only a few exceptions, Chapter 7 relief is open to all individuals and business entities; however, individual debtors must meet the Bankruptcy Code's "means test" to be eligible for Chapter 7 bankruptcy. Again, the means test only applies to individuals, and it determines

whether the Chapter 7 filing is presumptively abusive. A filing is presumptively abusive if the debtor's total current monthly income over five years, net of certain statutorily allowed expenses, is more than 1) \$13,650, or 2) twenty-five percent of the debtor's nonpriority unsecured debt, so long as that amount is at least \$8,175.

A Chapter 7 bankruptcy case does not involve the filing of a plan of repayment. Instead, the Court appoints a bankruptcy trustee who gathers and sells the debtor's nonexempt assets and uses the proceeds of such assets to pay holders of claims in accordance with the provisions of the Bankruptcy Code. A debtor can keep certain "exempt" property based on statutorily set exemptions, and the remaining assets are forcibly liquidated by the trustee. For this reason, Chapter 7 is not an option for businesses that wish to keep operating.

The Automatic Stay and the Estate

The filing of the petition "automatically stays" or stops most collection actions against the debtor or the debtor's property. However, filing the petition does not stay certain types of actions listed under Section 362(b) of the Bankruptcy Code. The stay stops all collections, foreclosures, suits, demands, etc.; however, creditors can petition the Court for relief from the automatic stay.

Filing of the petition in Chapter 7 creates a fictitious "estate." Operatively, the estate becomes the temporary legal owner of all the debtor's property, which consists of all legal or equitable interests of the debtor in property as of the date of commencement of the case, including property owned or held by another person if the debtor has an interest in the property. The debtor's creditors are then paid from the assets of the estate.

The Chapter 7 Trustee

The Court appoints an impartial case trustee to administer the case and liquidate the debtor's nonexempt assets as part of the estate. Many individual Chapter 7 cases are "no asset" cases where the assets are all subject to valid and enforceable liens and there is no non-exempt property to distribute. More frequently, business cases are "asset" cases, and unsecured creditors must file their claims with the Court within a prescribed period of time.

The role of a Chapter 7 trustee in an asset case is to liquidate the debtor's nonexempt assets in a manner that maximizes the return to the debtor's creditors. This is done by selling all the debtor's nonexempt property free and clear of liens. The Chapter 7 trustee also has broad avoidance powers that allow the trustee to recover money or property by 1) setting aside preferential transfers made to creditors within 90 days before the petition; 2) undoing security interests and other pre-petition transfers of property that were not properly perfected under non-bankruptcy law at the time of the petition; and 3) pursuing non-bankruptcy claims available under state law. The claims of creditors are then paid according to the distribution provisions of Section § 726 of the Bankruptcy Code.

For business debtors, the Court may authorize the trustee to operate the business for a limited period, especially if such operation will benefit creditors and enhance the liquidation of the estate. However, the trustee and not the debtor is in possession of the debtor's assets; the

business does not continue to operate as normal (at least for very long). Businesses liquidated under a Chapter 7 do not receive a discharge.

HOW TO START THE PROCESS OF FILING FOR BANKRUPTCY

In most situations, determining whether a business or individual would be best served by seeking the protections of the Bankruptcy Code is complicated and requires analysis of many factors.

If you have questions about whether your business might benefit from the bankruptcy provisions described above, then please reach out today and let our experienced team guide you to the best possible resolution of your business' financial problems. Waldrep LLP is a boutique law firm specializing in business bankruptcy, healthcare restructuring and insolvency, and long-term care. We offer a unique combination of top-tier credentials and efficient, individualized client service.

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