

Bankruptcy 101: Chapter And Verse

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While bankruptcies are generally down in most areas of the country, not here in Atlantic County. With many closed casinos and eight thousand foreclosures looming, individuals and businesses have been under pressure. It is expected that over the next few years individuals and businesses will be looking to re-organize or simply rid themselves of debt and obtain the “fresh start” a bankruptcy can provide. Bankruptcy is one strategy among many used to assist those in financial distress. This article will give a brief review of the bankruptcy alternatives. There are generally three statutory bankruptcy schemes known as Chapter 7, Chapter 11 or Chapter 13.

Chapter 7 is also referred to commonly as a “straight bankruptcy,” “basic bankruptcy” or “liquidating bankruptcy.” It is available for individuals no matter how much debt or assets they have. In an individual Chapter 7, a Trustee is appointed. In the event there are assets which exceed the individuals exemptions or exclusions, as described below, the trustee will sell those assets and tender the exempt funds to creditors. In most Chapter 7 filings, there are no assets which exceed exemptions or exclusions and the trustee simply closes the case without liquidating any assets.

The Chapter 7 is also available to corporations, partnerships, LLC’s etc. In a business Chapter 7 the assets are sold and the creditors receive all funds after costs of administration. This is used typically by a company that is out of business, where the principals have moved on.

A business entity can file a Chapter 11 in the event they want to re-organize, stay in business, and pay some percentage of their debt in an equitable manner. There are simplified provisions for small business filings. An individual can file a Chapter 13, which is similar to a business Chapter 11 in that some payment is typically made to creditors. There are certain income and debt limitations for the abbreviated Chapter 13 process. If those limits are exceeded, the individual would need to file the substantially more cumbersome and expensive Chapter 11. There are specific reasons that an individual would need to make some payment and file a Chapter 13 or 11.

Generally there are three major reasons why an individual would need to file a Chapter 13/11 as opposed to simply getting rid of all their debts with a Chapter 7. First, the Bankruptcy Code was amended in 2005 to require certain high income individuals to file a Chapter 13. Second, the individual might want to retain assets that otherwise might not be exempt. For example, currently there is a homestead exemption of \$23,675. One can retain one’s home and not pay any creditors if that were all the equity in the house. However if there were equity beyond the exemption, a Chapter 7 trustee would be required to sell the

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home, tender the exempt amount to the individuals and the balance to the creditors. By filing a Chapter 13, the individual could give the excess over the exemption in monthly payments not to exceed 60 months. You should be aware that there are many exemptions or exclusions from the bankruptcy estate that protect assets. One can retain \$1,283,025.00 in retirement accounts and potentially more depending upon the retirement account vehicle without exposing them in any way whatsoever to creditors. Lastly, they may want to force a creditor, like a mortgage holder to spread any back payments that are owed over the course of the 5 years and retain the home.

The decision of a business to file a Chapter 11 rather than simply liquidating in a Chapter 7 and perhaps just opening another company are not quite as clear cut. The decision is a complex one based upon the viability of the company, debt structure, true potential for reorganization and cost thereof. We require independent accountants to be involved with our clients to assure that the decision to file a Chapter 11 is based on sound judgment and not wishful thinking. Most Chapter 11 filings end up in liquidating Chapter 7's due to improper planning prior to filing the bankruptcy that can be avoided with the right advice.

In any case, the individual or business immediately upon filing obtains protection against creditors filing law suits or executing on assets. Creditors are precluded from beginning or proceeding with any legal actions or attempts to collect debts. This is commonly known as the automatic stay or Bankruptcy Code Section 362 stay. The whole issue of stopping creditors from proceeding after assets is a major, if not the major factor in filing bankruptcies. There are some creditors who aggressively seek to obtain payment, putting the individual's or business' peaceful existence in jeopardy.

In conclusion, bankruptcy is one of the vehicles we have to enable an individual to get a fresh start. In England there were debtor's prisons. Early on our legislature recognized the value of allowing individuals to shed their debts and re-build. It should be noted that an individual can only obtain a discharge once in 8 years. There has been much written about how the availability of bankruptcy for both individuals and businesses has driven great advances in our society. Individuals can take risks recognizing there is an out. Advances in aviation and technology were driven and continue to be driven on the backs of failures and bankruptcies. As they say, nothing ventured, nothing gained! It's good to know there is a way back if things go bad.

ATTORNEYS MENTIONED

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