A Guide to Financial Stabilization

Chapter 7 Liquidation

Chapter 11 Reorganization

Chapter 13 Personal Reorganization

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Bankruptcy and Reorganization

Bankruptcy relief is a civil right provided for by the U.S. Constitution, by which individuals, married persons and companies may obtain relief from debts as provided for by laws passed by the federal government. The U.S. Bankruptcy Code (Title 11 of the U.S. Code) is intended to provide a means to reorganize debts and obtain a fresh start. In recent history, debtors were incarcerated for failing to repay creditors, and to this day many countries provide no bankruptcy relief. The United States has enacted comprehensive bankruptcy laws for over two hundred years and a system of financial rebirth is the cornerstone of free market capitalism.

A person or company that owes money to someone else is known as the "Debtor," and the person or entity seeking payment or owed money by the Debtor is known as the "Creditor." Both debtors and creditors have rights under state and federal bankruptcy laws. There are two kinds of debts: "**secured debts**," debts supported or backed by collateral such as mortgages, security interests in vehicle titles, crops and equipment, and purchase money security interests in furniture or appliances, and "**unsecured debts**" are ones that lack collateral, such as credit cards, personal loans, medical and dental bills and trade debt. There are two basic kinds of property that people and companies own: **personal property** such as household goods, money, intangibles, wages and vehicles, and **real property**, which is land, buildings and homes. Under the law, a certain amount of a debtor's real and personal property is exempt from the reach or attachment of creditors in order to protect core assets from liquidation. These exemptions vary from state to state and to the kinds of property they protect, and usually only a person and not a corporation can assert property exemptions. Exemptions, the foundation to launching a fresh start, protect essential assets such as homes, vehicles, household goods and retirement accounts. In any proceeding under the U.S. Bankruptcy Code, an individual debtor normally seeks to obtain a "discharge" of debts, or permanently escape legal liability. The filing of a petition under any chapter invokes an "automatic stay" or injunction that prohibits creditors from taking further action to collect debts, and "discharge" results in a permanent injunction against creditors from future collection. The automatic stay afforded upon filing a bankruptcy petition stops all collection, including garnishments, foreclosures, lawsuits, and general harassment.

Forms of Relief

There are several chapters of laws under Title 11 of the U.S. Code. Chapter 7 is for businesses, individuals or married persons and may result in liquidation of non-exempt and unencumbered property. Chapter 7 affords discharge of debts owed by individuals, but not corporations. Chapter 11 is for business reorganizations of any type. Chapter 13 is for individuals and married persons with debts not exceeding certain limited amounts. Chapter 12 is for family farmers. Chapter 11, 12, and 13 allow debtors to reorganize their debts through payment plans over time while keeping key assets (e.g. homes and vehicles) while rejecting leases if necessary, surrendering items, and restructuring loans.

Chapter 7: Chapter 7 bankruptcy is the basic chapter for relief under the U.S. Bankruptcy Code. This procedure is commonly known as “bankruptcy.” In a Chapter 7 proceeding, property that has no applicable exemption or has value exceeding the total amount of secured loans and exemptions may be liquidated for the benefit of creditors. Unsecured debts are discharged in a relatively short period of time and the entire proceeding may be over in a matter of months. Certain types of debts may not be dischargeable in a Chapter 7 proceeding, such as government student loans, child support and recent taxes.

Secured creditors are treated in three basic ways. The debtor may surrender the collateral (real estate, vehicles, etc.) back to the creditor and avoid further payment. Second, the debtor may reaffirm the debt and agree to continue making regular payments and keep possession of the item at issue. Lastly, the debtor may redeem the collateral by paying the full value of the item in a lump sum.

Chapter 13: Chapter 13, as distinguished from Chapter 11, is designed for wage earners or persons with regular income and is referred to as a personal reorganization. In Chapter 13, debtors make monthly payments to a bonded trustee over the course of three to five years and payments are redistributed to creditors. Chapter 13 is used to save homes, repay secured debt, pay tax liabilities, and compromise unsecured creditors for a percentage of the original debt with no interest. The debtor may retain possession of property while paying secured debt over time. If the value of the debtor’s property exceeds in value the amount of secured loans and applicable exemptions, then the law requires that unsecured creditors be paid the equity in any property over the course of the plan. This is known as the liquidation test in that unsecured creditors must receive the cash equivalent, over the course of the payment plan, of what would have been received in a Chapter 7 bankruptcy. Additionally, debtors must commit excess disposable income from the monthly family budget to the Chapter 13 plan. Upon completion of plan payments, debtors receive a discharge of debts and are no longer liable for most debts.

Chapter 11: Chapter 11 reorganization is used by corporations and individuals who are ineligible for Chapter 13. Chapter 11 attorney’s fees and costs are considerably more than in Chapter 13. The goal in Chapter 11 is similar to Chapter 13. Creditors are forestalled while the debtor and creditors formulate a plan to repay creditors while saving the business of the debtor. Chapter 11 is a complicated process and failure to achieve confirmation of a plan may result in liquidation of assets for the benefit of creditors.

Chapter 12: Chapter 12 is designed to protect family farmers and operates similarly to Chapter 11 and 13 affording protection and discharge of debts to America’s farmers.

HOW BANKRUPTCY PROTECTS YOU

Bankruptcy proceedings differ fundamentally from debt consolidation, workouts, and efforts to compromise debt with individual creditors. The mere filing of the bankruptcy petition invokes an automatic stay or federal injunction, prohibiting creditors from any further action against the debtor. Bankruptcy is far more effective at stopping creditor action because of the automatic stay or injunction and involvement by federal bankruptcy courts, with the power to issue court orders. Credit card consolidation and other attempts to deal with creditors require creditor participation and approval, but in bankruptcy court, debtors are afforded greater rights. In bankruptcy court, debtors are required to be forthright and disclose all assets and liabilities to the federal court. The process involves complete disclosure of assets, creditors, and the debtor’s earning capacity through the filing of bankruptcy schedules. In exchange for complete disclosure, the federal law provides protection to debtors against creditor harassment, lawsuits and collection activities. Debtors must attend a meeting of creditors with their attorney and undergo a brief examination of their assets, liabilities and plan feasibility.

HOW CREDIT WORKS

Personal credit is governed by federal and state laws and tracked by three major credit bureaus. Non-payment or slow payment negatively affects one’s credit rating or score. Non-payment is reported for at least seven years from the date of the creditor’s last report, while bankruptcy is reported from the date of the petition. Over time, after debts are discharged, credit scores improve and credit becomes more available. Debtors should take affirmative steps to rebuild credit through repayment of secured debts or use of secured credit cards, available at many banks.