



Bankruptcy – An Overview of the Process and the Bankruptcy Court’s Authority

**By Charles M. Delacruz
Counsel for Public Affairs
National Grain and Feed Association**

[Editor’s Note: Given recent developments, the NGFA is providing this information to members concerning the bankruptcy process and the authority of the bankruptcy court to restructure existing contractual arrangements between companies filing for bankruptcy and their suppliers. The bankruptcy process is highly complex, involving an extensive body of detailed laws, rules and procedures. This general information does not represent legal advice or NGFA’s views on any pending or future bankruptcy matter. Those individuals or companies involved (or potentially becoming involved) in a bankruptcy case should consult competent legal counsel.]

* * *

The Bankruptcy Code, which has been amended several times since its enactment in 1978, is the uniform federal law that governs all bankruptcy cases. The bankruptcy process established under this code is governed by uniform federal rules and the local rules of each bankruptcy court. There is a federal bankruptcy court for each of the 90 federal judicial districts in the United States, with each state having one or more districts.

The bankruptcy judge has ultimate discretion and decision-making power over bankruptcy cases. The bankruptcy judge may decide any matter connected with a case, including whether a debtor is eligible to file for bankruptcy. Importantly, the judge also has authority to decide which debts and obligations of a company found eligible for bankruptcy are to be honored, and which are to be discharged (dismissed or modified). Often, the attorneys for the company filing for bankruptcy will make specific requests to the bankruptcy court as to which, if any, contracts to honor.

Much of the bankruptcy process is administrative, and is conducted away from the courthouse. In certain cases, this administrative process is implemented by a trustee appointed to oversee the case. Depending upon the type of bankruptcy case, the trustee may be a private individual or corporation whose responsibilities include reviewing the debtor’s petition and schedules, liquidating the estate property, making distributions to creditors and bringing actions against creditors or the debtor to recover property of the bankruptcy estate. Often, the only formal proceeding at which the interested parties appear is the meeting of the creditors – informally called a “341 meeting” – during which creditors can question the debtor about debts and property.

Significantly, the moment a bankruptcy petition is filed, it results in an automatic stay that enjoins lawsuits, arbitration proceedings, foreclosures, garnishments and all collection activities against the debtor.

Types of Bankruptcy Cases

There are several types of bankruptcy cases, each of which equates with a specific chapter of the bankruptcy code:

▶ **Chapter 7 (Liquidation):** This type of bankruptcy provides for “liquidation,” or sale, of the debtor’s nonexempt property and the distribution of the proceeds to creditors. Chapter 7 contemplates an orderly, court-supervised procedure under which a trustee takes control of the assets of the debtor’s estate, reduces them to cash, and makes distributions to creditors – all subject to the rights of secured creditors (*creditors with the right to hold or sell certain property of the debtor in satisfaction of a claim, such as a mortgage, pledge of collateral or lien*) and the debtor’s right to retain certain “exempt property” (*property that the law permits the debtor to keep from unsecured creditors*).

An “unsecured claim” is a debt for which credit was extended based solely upon the creditor’s assessment of the debtor’s future ability to pay. Debtor obligations from prior court and arbitration decisions are unsecured debts. An unsecured creditor receives a distribution only when assets are available for unsecured claims and if the creditor files a proof of claim with the bankruptcy court. A “proof of claim” (*an official form used solely for this purpose*) is a written verified statement that describes the reason the debtor owes the creditor money.

▶ **Chapter 11 (Reorganization):** This type of bankruptcy generally provides for reorganization of a corporation or partnership. The debtor usually proposes a reorganization plan to keep its business operating and to pay creditors concurrently through a court-approved plan of reorganization. The Chapter 11 debtor usually has the exclusive right to submit a reorganization plan for the first 120 days after it files the case, and is required to provide creditors

with a disclosure statement containing information adequate to enable creditors to evaluate the plan.

The court ultimately approves or disapproves the reorganization plan. Under the confirmed plan, the debtor can reduce its debts by repaying a portion of its obligations and discharging others. The debtor also can terminate “burdensome” contracts and leases, recover assets and rescale its operations in an effort to return to profitability. Under Chapter 11, the debtor normally goes through a period of consolidation and emerges with a reduced debt load and a reorganized business. If the business still cannot operate when in Chapter 11, moving to liquidation under Chapter 7 is an option that can be initiated by either the debtor or a group of creditors.

Other forms of bankruptcy are:

- ▶ **Chapter 13**, which allows individual debtors with a regular source of income to retain property and pay debts over time.
- ▶ **Chapter 12**, which provides debt relief similar to Chapter 13 for “family farmers and fishermen with regular income.”
- ▶ **Chapter 9**, which provides reorganization similar to Chapter 11 for a “municipality,” such as cities, towns, villages, counties, taxing districts, utilities and school districts.
- ▶ **Chapter 15**, which provides a mechanism for addressing cases involving cross-border insolvencies.

The “Bankruptcy Discharge”

The official goal of the bankruptcy process – to give debtors a financial “fresh start” – is accomplished primarily through the **bankruptcy discharge**. This mechanism permanently releases debtors from personal liability from specific debts and prohibits creditors from taking any action against the debtor to collect those debts, including legal action and communications, such as telephone calls, letters and personal contacts.

The following are some facts about the bankruptcy discharge mechanism:

- ▶ Although a debtor personally is not liable for discharged debts, a **valid lien** (a charge upon specific property to secure payment of a debt) that has not been avoided (made unenforceable) in the bankruptcy case will remain in effect after the bankruptcy case is concluded. Therefore, a secured creditor may enforce the lien to recover the property secured by the lien.
- ▶ Not all debts are discharged, as Congress determined that certain debts are not dischargeable for public policy reasons. The debts discharged vary under each chapter of the Bankruptcy Code. Examples include home mortgages, taxes, governmental fines and penalties, and some government-funded or guaranteed loans or benefit overpayments, which still must be repaid after bankruptcy.
- ▶ In Chapter 7 cases, an objection to a discharge may be filed by a creditor or the trustee. Creditors receive a notice shortly after the case is filed containing important information, including the

deadline for objecting to the discharge. To object to the debtor’s discharge, a creditor must file a complaint in the bankruptcy court before the deadline. The court may deny a Chapter 7 discharge for numerous reasons, including fraudulent acts and failure to account for the loss of assets. In other cases, creditors can object to the reorganization and payment plan; but they cannot object to the discharge once the plan payments are completed.

- ▶ The court may revoke a discharge or order of confirmation of a plan under certain circumstances, such as fraud.
- ▶ Even if a discharged debt no longer can be enforced legally, a debtor still may repay it voluntarily, such as when it is in the interest of the debtor’s reputation.
- ▶ If a creditor takes any action designed to collect a discharged debt, the court can impose sanctions on the creditor, which usually consists of a civil contempt citation often punishable by a fine.

Glossary/Additional Concepts

Other terms commonly used in bankruptcy proceedings include:

- ▶ **Disclosure Statement:** A document prepared by the Chapter 11 debtor or other plan proponent designed to provide “adequate information” to creditors to enable them to evaluate the Chapter 11 reorganization plan.
- ▶ **Priority:** The Bankruptcy Code’s statutory ranking of unsecured claims that determines the order in which unsecured claims will be paid if there is insufficient money to pay all unsecured claims in full. For example, under the Bankruptcy Code’s priority scheme, money owed to the case trustee or for pre-petition alimony and/or child support is required to be paid in full before any general unsecured debt (*i.e. trade debt or credit card debt*).
- ▶ **Schedules:** Detailed lists filed by the debtor along with, or shortly after, the petition showing the debtor’s assets, liabilities and other financial information. There are official forms a debtor is required to use. An **unscheduled debt** is a debt that should have been listed by the debtor in the schedules filed with the court, but was not. Depending upon the circumstances, an unscheduled debt may or may not be discharged.
- ▶ **Statement of Financial Affairs:** A series of questions the debtor is required to answer in writing concerning sources of income, transfers of property, lawsuits by creditors, etc. Again, the debtor is required to use an official form.

Conclusion

Often, filings and information related to selected information from specific bankruptcy cases may be available to the public electronically through a system known as **PACER**. Users are required to establish an account to acquire access to PACER (www.pacer.psc.uscourts.gov), and pay a per-page fee to download and copy documents filed electronically.