

**BANKRUPTCY FOR THE NON-BANKRUPTCY LAWYER:  
WHAT YOU NEED TO KNOW  
TO STAY OUT OF TROUBLE**

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**Johnston Mitchell  
Christine Coers-Mitchell**

**COERS MITCHELL LAW LLC  
2100 NE Broadway St., Suite 105  
Portland, Oregon 97232  
503.719.6795**

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## **About our Speakers**

***Christine Coers-Mitchell*** received her J.D. from Gonzaga University School of Law. She maintains a business and bankruptcy practice. She assists closely-held businesses in entity formation, contract review, and litigation. With respect to bankruptcy, Ms. Coers-Mitchell provides analysis and advice regarding creditor claims and rights. She represents creditors in filing claims, contesting discharges, and adversary proceedings. Ms. Coers-Mitchell has also represented parties in complex litigation and appeal in the areas of bankruptcy, product liability, and professional malpractice. She is on the defense panel for the Oregon State Bar Professional Liability Fund. Prior to forming Coers Mitchell Law LLC, Ms. Coers-Mitchell was a partner with Cosgrave Vergeer Kestrel LLP and an attorney with McEwen Griswold LLP. She also served as an appellate law clerk for the Honorable Judge William Richardson.

***Johnston Mitchell*** received his J.D. from Gonzaga University School of Law. Mr. Mitchell has been in private practice for 17 years and is currently practicing at Coers Mitchell Law LLC. His practice focuses on debtor/creditor rights and business litigation. Before entering private practice, he was a judicial law clerk for the Honorable Elizabeth Perris. Mr. Mitchell is a member of the Professional Liability Fund Defense Panel.

## Introduction

Have you been in the uncomfortable position of discovering that your client filed a chapter 7 bankruptcy without telling you and now a bankruptcy trustee is negotiating a settlement with opposing counsel? Or, perhaps you discover the opposing party filed bankruptcy 3 years ago, but never listed your client's claim or your client as a creditor. How about that default judgment that was entered the day after the defendant filed a bankruptcy filing – is the judgment a lien on the judgment debtor's property or not? Did you and your client violate the automatic stay? Is there anything you can do to prevent that sizable equalizing judgment from being discharged in a future bankruptcy by your client's ex?

While you may not choose to practice in bankruptcy court, chances are that you will be confronted by a bankruptcy filing or the possibility of one happening when representing your client. Knowing a few bankruptcy basics and problem areas may save your client.

## Bankruptcy Basics

Bankruptcy policies and basic terms you should know.

### A. Two Underlying Policies in all Bankruptcies.

Knowing the underlying policies of bankruptcy helps in understanding the bankruptcy process and law. Courts rely on these policies when interpreting the Bankruptcy Code and may impact the court's decision.

#### 1. Fresh start for the debtor.

The “fresh start” policy underlies a debtor's discharge. By fully disclosing the debtor's financial information, an honest debtor is relieved – “discharged” – of personal liability for most pre-bankruptcy debts. Upon discharge, an injunction arises that prohibits collection of discharged debts from the debtor. A discharge (1) voids any judgment; (2) enjoins any collection; and (3) stops commencement or continuation of legal action against the debtor and the debtor's property. 11 U.S.C. § 524.

#### 2. Equal treatment for similarly situated creditors.

The Bankruptcy Code is also based on a policy of treating similarly-situated creditors equally. With the commencement of a bankruptcy case, creditors must look to the bankruptcy estate to collect. Creditors holding similar types of claims receive pro rata distribution from the bankruptcy estate. To support this policy, the Bankruptcy Code provides a forceful collection process. A bankruptcy trustee has unique avoidance and recovery powers. Certain liens may be avoided and certain prebankruptcy transfers may be recovered and distributed among creditors.

### B. Sources of Bankruptcy Law.

Bankruptcy law is statute and rule driven. That being said, state law frequently interplays with federal law in resolving bankruptcy issues. For example, state law will determine property

rights and may determine property that a debtor may exempt from distribution in a bankruptcy case. The primary sources of bankruptcy law and procedure are as follows:

### **1. Title 28**

Title 28 of the US Code governs several aspects of bankruptcy, including jurisdiction, venue, removal, appeals, bankruptcy trustees and judges. Some significant provisions include:

- Bankruptcy Court Jurisdiction (28 U.S.C. § 1334)
- Bankruptcy Court Venue (28 U.S.C. § 1408)
- Change of Venue (28 U.S.C. § 1412)
- Removal from state court (28 U.S.C. § 1445 - § 1452)
- Appeals (28 U.S.C. § 158)

### **2. Title 11**

Title 11 of the US Code comprises the bulk of federal bankruptcy law and procedure and is generally referred to as the “Bankruptcy Code” or simply, “the Code” by bankruptcy judges and practitioners. The Code is organized in the following chapters (some of which correspond with a particular type of bankruptcy filing):

- Chapter 1 – General Provisions** (e.g., definitions, rules of construction, who may be a debtor). 11 U.S.C. § 101 *et. seq.*
- Chapter 3 – Case Administration** (e.g., automatic stay, sale of property, unexpired leases). 11 U.S.C. § 301 *et. seq.*
- Chapter 5 – Creditors, The Debtor, and The Estate** (e.g., creditors’ claims, priorities, debtor’s duties, property of the estate). 11 U.S.C. § 501 *et. seq.*
- Chapter 7 – Liquidation** (e.g., liens, discharge). 11 U.S.C. § 701 *et. seq.*
- Chapter 9 – Adjustment of Debts of a Municipality.** 11 U.S.C. § 901 *et. seq.*
- Chapter 11 – Reorganization** (e.g., claims, plan, confirmation, creditors’ committee). 11 U.S.C. § 1101 *et. seq.*
- Chapter 13 – Adjustment of Debts of an Individual with Regular Income** (e.g., plan, confirmation, discharge). 11 U.S.C. § 1301 *et. seq.*
- Chapter 15 – Ancillary and Cross-Border Cases.** 11 U.S.C. § 1501 *et. seq.*

### **3. Bankruptcy Rules**

The Federal Rules of Bankruptcy Procedure govern procedures in cases filed pursuant to the Bankruptcy Code. Some of the Rules are unique to bankruptcy; others incorporate certain Federal Rules of Civil Procedure and Evidence. The Rules are organized as follows:

- a. Part 1, Commencement of bankruptcy case, proceedings relating to petition and order for relief. Rule 1001 *et. seq.*
- b. Part 2, Officers and administration, notices, meetings, examinations, attorneys and accountants. Rule 2001 *et. seq.*
- c. Part 3, Claims and distributions to creditors and equity interest holders, plans. Rule 3001 *et. seq.*
- d. Part 4, The debtor: duties and benefits. Rule 4001 *et. seq.*
- e. Part 5, Courts and clerks. Rule 5001 *et. seq.*
- f. Part 6, Collection and liquidation of the estate. Rule 6001 *et. seq.*
- g. Part 7, Adversary proceedings. This series incorporates certain Federal Rules of Civil Procedure. Rule 7001 *et. seq.*
- h. Part 8, Appeals to district court and bankruptcy appellate panel. Rule 8001 *et. seq.*
- i. Part 9, General provisions. Rule 9001 *et. seq.*

#### **4. Local Bankruptcy Rules**

The Local Bankruptcy Rules (“LBR”) generally follow the numbering of the Bankruptcy Rules. The LBRs were last updated on December 1, 2014. You can find a link to these rules on the District of Oregon Bankruptcy Court website – <http://www.orb.uscourts.gov/rules>.

#### **5. Local Federal District Court Rules**

Two Local District Court Rules (“LR’s”) also come in to play. LR 2100 provides for the local reference of bankruptcy matters to the bankruptcy courts. LR 2200 governs appeals to the District Court. You can find links to these rules on both the District of Oregon Bankruptcy Court website (<http://www.orb.uscourts.gov/rules>) and the District Court Website (<https://www.ord.uscourts.gov>).

### **C. Types of Bankruptcy.**

#### **1. Liquidation – Chapter 7**

In a Chapter 7 case, the court appoints a trustee who collects the nonexempt property, converts the property into cash and distributes the cash to creditors. The debtor gives up all nonexempt property to get a discharge—meaning a debtor has no further personal liability for prebankruptcy debt. A Chapter 7 bankruptcy provides a fast, affordable fresh start.

**NOTE:** While a business may file or convert to a Chapter 7, a business cannot receive a discharge of debt in a chapter 7.

## **2. Reorganizations**

In reorganizations, the debtor retains assets and creditors look to future income to be paid on debts or a portion of debt pursuant to a plan that meets Code requirements.

- a. Chapter 11 – entity and individual.** This chapter is available to individuals, partnerships, corporations and other entities. Generally, a Chapter 11 is more complex and costly.
- b. Chapter 13 – individual wage earner.** This chapter is only available for individual wage earners. (So, no job, no chapter 13). Only an individual with regular income and less than \$383,175 of unsecured debt and less than \$1,149,525 of secured debt is eligible. A chapter 13 has some advantages: (1) a debtor receives a “super” discharge (*i.e.*, can discharge certain debts, not otherwise dischargeable), (2) a debtor retains nonexempt assets, and (3) a debtor can repay fair market value of secured debt (e.g., on a residence). There are other advantages.
- c. Chapters 9 – municipality.** Detroit and Stockton have both used Chapter 9.
- d. Chapter 12 – family farmer.** Only a family farmer with regular income is eligible for a Chapter 12 bankruptcy. A farmer means a person who receives more than 80% of gross income from a farming operation.

## **D. Bankruptcy Case and Litigation**

Bankruptcy involves 3 types of “proceedings” – the main case, contested matters and adversary proceedings. There are two types of litigation proceedings in bankruptcy court – a contested matter and an adversary proceeding. The main difference between the two types of litigation is the amount of due process afforded to the litigants. What due process requires turns on the rights at issue.

### **1. Main case.**

The “main case” refers to the actual bankruptcy case. The main case is the “umbrella” proceeding for activity involving the debtor. Pleadings and documents relevant to the administration of the debtor’s bankruptcy are filed in the main case, including schedules, plans, claims, notices, orders etc.

### **2. Contested Matter.**

A contested matter refers to disputes that are initiated and resolved by motion filed in the main case. Bankruptcy Rule 9014 governs procedure in contested matters. Procedure is less formal; so for example, some civil rules of procedure are incorporated, but others are not. Bankr. R. 9014(c). Many disputes in a bankruptcy case may be initiated and decided by motion practice. Common issues resolved as a contested matter include objection to claims, motions for relief from the automatic stay, litigations regarding exemptions and the valuation of property.



### **3. Adversary Proceeding.**

Some litigation associated with bankruptcy requires more due process, because of the rights involved. Bankruptcy Rule 7001 list the situations that require to be brought as an adversary proceeding, including a proceeding to recover money or property, to determine validity, priority and extent of a lien, to object to or deny discharge, or to obtain an injunction or equitable relief. An adversary proceeding is initiated by filing and serving a complaint. An adversary proceeding, unlike a contested matter, receives a separate case number. Part VII of the Federal Rules of Bankruptcy Procedure governs the procedure of an adversary proceeding and incorporates many of the Federal Rules of Civil Procedure, in whole or in part. In general, an adversary proceeding is more like an ordinary lawsuit in United States District Court.

## **Bankruptcy Traps**

### **A. The Automatic Stay (11 U.S.C. § 362)**

#### **1. What is it?**

One of the main benefits of filing for bankruptcy is the protection provided by the automatic stay. The automatic stay arises by operation of statute (11 U.S.C. § 362(a)) with the filing of a voluntary or involuntary petition. The stay halts actions against the debtor and property of the debtor. The purpose of the stay is to give a debtor “breathing time” to reorganize or to obtain a fresh start. The stay benefits all creditors of the debtor by freezing the status quo.

#### **2. What does it prohibit?**

The automatic stay is broad. It applies to all “entities” and enjoins most action against the debtor and the debtor’s property, including the following:

- **Commencement or continuation of any litigation against debtor or estate property.**
- **Enforcement of judgment against debtor or estate.**
- **Act to obtain estate property or property from the estate.**
- **Act to collect, assess or recover pre-bankruptcy claim.**

#### **3. Exceptions**

Despite this breadth, the stay does not halt all action. 11 U.S.C. § 362(b) lists numerous exceptions including:

- Criminal actions against the debtor
- Withholding income to pay domestic support
- Certain acts to perfect a security interest
- Certain acts by taxing authorities such as audits, notice of deficiency and assessment.

In addition to § 362(b), there are three other significant circumstances in which the stay may not apply:

- **The Bankruptcy Code limits the stay for certain repeat bankruptcy filers.** The automatic stay may not go into effect if the debtor filed 2 or more prior cases within a year and those cases were dismissed, unless the court grants a timely request by the debtor based on a showing of good faith. 11 USC § 362(c)(4). The creditor may also request an order from the bankruptcy court that the stay does not apply. 11 USC § 362(c)(4)(a)(ii).
- **The automatic stay does not enjoin acts to recover against third parties who may be liable on the same debt, such as guarantors, insurers and sureties.**
- **The stay does not apply to prevent the debtor from initiating and prosecuting an action.** *Eisinger v. Way (In re Way)*, 229 B.R. 11, 13 (9th Cir. BAP 1998) (primary policy considerations do not exist where debtor has initiated a lawsuit against a creditor). In turn, a defendant in an action brought by a plaintiff/debtor may defend itself in that action without violating the automatic stay. *In re Palmdale Hills Prop., LLC*, 423 B.R. 655, 663-64 (B.A.P. 9th Cir. 2009) *aff'd*, 654 F.3d 868 (9th Cir. 2011) (citing *Gordon v. Whitmore (In re Merrick)*, 175 B.R. 333, 336 (9th Cir. BAP 1994) and *In re Way*, 229 B.R. at 13).

#### **4. How long does the stay last?**

The automatic stay remains in effect until the earliest of the following: (a) the time the bankruptcy case is closed, (b) the time the case is dismissed, or (c) the time discharge is granted or denied. 11 USC § 362(c)(2). The stay of an act against property of the estate continues until such property is no longer property of the estate, 11 U.S.C. § 362(c) (1), or the Bankruptcy Court grants a motion for relief from stay under 11 U.S.C. § 362(d).

In addition, the stay may be limited to the first 30 days after filing for certain acts, if the individual had a case pending within the prior year but was dismissed. To continue the stay, the debtor must file request within the first 30 days and show that the new filing has been made in good faith.

#### **5. What happens if my client violates the stay?**

There are two major concerns if action has been taken in violation of the automatic stay:

- **Actions taken in violation of the stay are void.** *Schwartz v. United States (In re Schwartz)*, 954 F.2d 569, 575 (9th Cir.1992); *40235 Washington St. Corp. v. Lusardi*, 329 F.3d 1076, 1080 (9th Cir. 2003). So, a transfer, foreclosure, or a judgment that is in violation of the automatic stay is void (not voidable) and of no effect.
- **If you violate the automatic stay, an individual debtor may seek damages against you, including actual and punitive damages, attorneys' fees and costs.** 11 U.S.C. § 362(k). Actual damages may include recovery for emotional distress. *In re Dawson*, 390 F.3d 1139, 1148 (9th Cir. 2004). To recover damages, the Code requires a "willful violation," which is established if (1) the creditor knew of the stay and 2) the creditor's actions that violated the automatic stay were intentional. *In re Roman*, 283 B.R. 1, 8 (B.A.P. 9th Cir. 2002). In other words, the debtor does not have to

prove that the creditor intended to violate the stay. Furthermore, knowledge of the bankruptcy filing is the legal equivalent of knowledge of the automatic stay. *In re Ozanne*, 337 B.R. 214, 220 (B.A.P. 9th Cir. 2006)

**6. What do you do if you receive notice or discover a bankruptcy filing?**

- a. Verify bankruptcy was filed.** Bankruptcies are usually easy to verify by doing a search via PACER (Public Access to Court Electronic Records).
- b. Suspend litigation and/or collection actions.** This means contacting and notifying third parties who are acting on the creditor's behalf.
- c. Determine whether or not the stay applies.** If unsure, get clarification from court.
- d. Notify the court where litigation is pending** (if applicable). UTCR 7.050; ORAP 8.20;
- e. Seek relief from the automatic stay or seek "comfort order" that stay does not apply.**
- f. If your client filed the bankruptcy, determine who is in control of your client's claim or defense.** If your plaintiff client files a chapter 7, control over the case may be in the hands of the chapter 7 trustee (see property of the estate, below.)

**7. Tips:**

- a. Check for Bankruptcy.** You should always ask if the client filed for bankruptcy and run a PACER check on our client and opposing parties before engaging in collection activity or filing an action.
- b. Make nice.** Usually a debtor's (or his attorney's) threat to seek damages for a stay violation can be addressed by simply ending collection efforts. This includes calls, letters and other contact with the debtor by the creditor and the creditor's agents (including the attorney for the creditor). After a bankruptcy filing, efforts should be directed to the procedures in bankruptcy court (filing a motion for relief from stay, filing a proof of claim, filing an adversary action to determine property rights etc.).
- c. Consider *Nunc Pro Tunc* Relief from Stay or Retroactive Relief.** You may be able to undo the effect of a void transaction by obtaining relief from stay that dates back to the date the petition was filed. This won't work to effectuate a foreclosure, but may work to allow entry of a judgment.
- d. Consider continuing litigation for purpose of pursuing insurance proceeds.** If the debtor defendant doesn't have assets and the only thing really at stake are insurance proceeds, you may want to consider a motion for relief from stay for the sole purpose of liquidating the claim to recover against an insurance policy. A court is likely to grant that relief (and the debtor may even stipulate). This will get a case up and running with less effort. You can amend your complaint to make that purpose a specific allegation. And, a later judgment won't violate the injunction protecting debtor's discharge from personal liability.

- e. **Investigate.** Bankruptcy schedules, statement of financial affairs and other bankruptcy filings can provide a wealth of information about the debtor and his or her creditors, regardless of whether or not the automatic stay applies.
- f. **Check statutes of limitation carefully.** Bankruptcy tolls the limitation periods under non-bankruptcy law and for non-bankruptcy proceedings for the bankruptcy trustee, the debtor, and parties having claims against the debtor. 11 Section 108 provides the relevant periods for particular circumstances.

## **B. Discharge**

### **1. What is it?**

Obtaining a discharge is a main benefit of filing for bankruptcy. After completing the requirements in a Chapter 7, Chapter 13 or Chapter 11, the bankruptcy court enters an order that discharges **the debtor from liability for debts scheduled by the debtor**. The scope of the debtor's discharge depends on the chapter filed and the type of debt.

- In a Chapter 7, claims that arose before the bankruptcy filing are discharged.
- In a Chapter 13, claims covered in a plan are discharged.
- In a Chapter 11, claims that arose before the order confirming the plan are discharged.

### **2. What a discharge isn't.**

It is important to understand what a discharge doesn't do:

- A discharge does not eliminate the debt. It means that a debtor is not personally liable.
- A debt which is not listed in the debtor's schedules is not discharged unless the case is designated as a "no asset" case.
- A discharge does not affect the liability of anyone else (e.g., guarantor or joint tortfeasor).
- A discharge does not enjoin collection against property securing a prebankruptcy debt. Thus, after bankruptcy, a creditor may foreclose on the security for a debt – car, residence etc. – because of a default.
- Only an individual can obtain a discharge in a Chapter 7 or Chapter 13 bankruptcy.

### **3. Non-Dischargeable Debts.**

Certain types of debts may be non-dischargeable. Section 523(a) lists these debts and includes: (a) certain tax debts, (b) debts incurred by fraud, (c) debts for fraud or defalcation as a fiduciary, larceny or embezzlement, (d) debts for willful and malicious injury, and (e) debts for death or personal injury caused by the debtor's unlawful operation of a motor vehicle while intoxicated. There is a long list, which is worth reviewing. Two important caveats to note:

- **Certain non-dischargeable debts will be discharged, unless a creditor takes action. 11 U.S.C. § 523(c)(1).**

- **If a debtor successfully completes a Chapter 13 plan, the debtor can discharge some of the Section 523 debts. This is sometimes referred to as the “super discharge.”**

#### **4. Denial of discharge**

A debtor may be denied discharge of all debts. Section 727 states the bases for denying discharge in a Chapter 7. A debtor who has engaged in wrongful or prohibited conduct may be denied a discharge. The grounds for denial include: (a) fraudulently transferring property one year prior to the commencement of a bankruptcy, (b) failing to keep adequate records, (c) failing to adequately explain finances, (d) committing perjury, and (e) disobeying a court order.

#### **5. Tips.**

- Pay attention to notices with deadlines.** A request to deny the discharge of a debt or to request denial of all debts must be made by filing a timely adversary complaint. The deadlines are usually stated in the notice of bankruptcy which all listed creditors receive at the beginning of a case or in a separate notice to creditors.
- Consider liability of third parties.** Because the discharge injunction applies only to the debtor's personal liability it does not inhibit collection efforts against other entities. In fact, a creditor may continue an action against the debtor post discharge for the sole purpose of liquidating a claim for insurance proceeds. *In re Beeney*, 142 B.R. 360, 362 (B.A.P. 9th Cir. 1992). It is not necessary to name the insurance company; amending the complaint to provide that the plaintiff seeks to liquidate a claim for insurance proceeds and does not seek a judgment holding defendant personally liable is usually sufficient to avoid a violation of the discharge injunction.
- Consider nature and characterization of claims and debts.** Give some thought as to whether a particular claim might be dischargeable or not in a future bankruptcy. So, for example, you might want to structure a settlement in a divorce case to provide more support or alimony or take a trust deed rather than merely taking an equalizing judgment which could be discharged in a chapter 13. You also might want to allege facts in a fraud claim that would meet the non-dischargeable elements under 11 U.S.C. § 523.

### **C. Property of the Estate**

#### **1. What is it?**

When a debtor files for bankruptcy, an estate is created. 11 U.S.C. § 541(a). Property of a bankruptcy estate includes:

- “All legal or equitable interests of the debtor in property as of the commencement of the case,” 11 U.S.C. § 541(a)(1);
- Interests in community property over which the debtor has sole, equal or joint management and control, 11 U.S.C. § 541(a)(2);

- Inheritances, life insurance and property received through divorce settlement acquired within 180 days after the bankruptcy filing, 11 U.S.C. § 541(a)(5); and
- Proceeds from property of the estate, 11 U.S.C. § 541(a)(6).

**Note:** Property of the estate includes unvested, contingent interests. Thus, a claim is an interest in property. So, if your client is suing another party on a claim that arose pre-petition, that claim (and any judgment or settlement proceeds) is property of the estate unless exempt or abandoned to the debtor. It is not always easy to tell if a claim held by a debtor is property of the estate. Courts are split on how to analyze the issue. *See In re Alvarez*, 224 F.3d 1273, 1276-77 (11th Cir. 2000) (discussing tests); the current predominant test is whether the claim accrues under state law prior to the petition date, without considering whether the claim had been discovered.

## 2. What is not included in the estate?

The bankruptcy estate does not include the following:

- Wages and property earned by Chapter 7 debtor after the petition is filed.
- A debtor's interest in a terminated nonresidential lease.
- Specialized education funds, and contributions to specific retirement accounts
- Allowable exempt property designated by the debtor under federal or state law.

## 3. Why does it matter?

Whether property is part of a debtor's bankruptcy estate can matter a lot:

- The automatic stay applies.** The stay applies to actions taken against property of the estate. So, a foreclosure may be void if title to the property is held in the name of the individual rather than a non-debtor company. Actions in violation of the stay may subject you and your client to claim for damages.
- You may be dealing with the wrong party.** In a Chapter 7, the Chapter 7 trustee holds and controls the property of the estate for the benefit of all creditors. Property transfers, settlement agreements and continuing the prosecution of a debtor's claim should all go through the chapter 7 trustee or may be invalid.
- You or your client may have to turn over property.** If you or your client has property of the debtor's estate (e.g., car, deposit, documents, etc.) the trustee may require turnover of that property to the estate.

## 4. Tips.

- Check.** Before executing on a judgment, conducting a foreclosure sale, transferring property, do a PACER and check to see if any of the parties has filed bankruptcy and, if so, the status of the bankruptcy before proceeding.
- If your client filed for bankruptcy, work with your client's bankruptcy counsel and, if applicable, Chapter 7 trustee.** To continue pursuing the claim, you may need to be appointed as counsel for the debtor or trustee, the pursuance of the claim and your compensation may need to be included in any filed plan.

**c. Strategize.** If you have a question about whether property is in the estate, consider moving for relief from stay on a cautionary basis, preserving all arguments. You might want to consider filing an adversary complaint to resolve a question regarding property of the estate. Bankruptcy litigation generally follows a fast track and bankruptcy judges regularly decide property issues and have clerks and time to examine nuanced issues (as opposed to many state court judges).

## **D. Pre-Bankruptcy Transfers**

### **1. What is it?**

The Bankruptcy Code broadly defines a “transfer” as:

- a. the creation of a lien;
- b. the retention of title as a security interest;
- c. the foreclosure of a debtor's equity of redemption; or
- d. each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with--
  - i. property; or
  - ii. an interest in property.” 11 U.S.C. § 101 (54).

### **2. Why does a transfer matter?**

The trustee has the right to reclaim for the benefit of the bankruptcy estate, money or property that the debtor transferred within the 90 days before bankruptcy. 11 U.S.C. § 547(b). This period is extended to 1 year for insiders (*e.g.*, a relative of the debtor or entity in which the debtor is involved, or for corporations, a director, officer, or person in control, 11 U.S.C. § 101 (31)). 11 U.S.C. § 547(b). In the case of fraud, the period is extended to 2 years before the date of filing bankruptcy. 11 U.S.C. § 548.

A trustee will either make a demand for the return of the money or property transferred or file an adversary proceeding making such demand.

### **3. What transfers are avoidable?**

#### **a. Preferences - 11 U.S.C. § 547**

Under Section 547(b), the trustee can avoid (i.e., undo):

- i. A transfer of a debtor’s property;
- ii. To or for the benefit of a creditor;
- iii. On account of an antecedent debt owed before the transfer;
- iv. Made while a debtor was insolvent;
- v. Made during preference period (90 days or 1 year for an insider); and

- vi. That allows a creditor to receive more than the creditor would receive in hypothetical Chapter 7.

Defense of a preference claim may be based on the individual elements or various statutory defenses. There are three main statutory defenses:

**i. Subsequent new value.** A creditor may keep the transfer:

- To extent the creditor gives new value extended after the challenged transfer, and
- New value remains unpaid (by debtor).

This defense often requires a detailed analysis of the dates of delivery and services compared to payments.

**ii. Contemporaneous exchange – C.O.D. defense.** A creditor may keep the transfer if:

- The transfer was intended to be contemporaneous,
- The transfer was in fact contemporaneous, and
- New value given.

**iii. Ordinary course defense.** A creditor may keep the transfer if:

- The debt was incurred in the ordinary course of business, and
- The transfer was made in the ordinary course of business or the transfer was made according to the ordinary business terms.

**b. Fraudulent transfers - § 548**

Under Section 548, the trustee may undo transfers made by the debtor or obligations incurred by the debtor, within 2 years of the bankruptcy petition when:

- i. The debtor made the transfer with actual intent to hinder, delay or defraud creditors, or
- ii. The debtor received less than reasonably equivalent value in exchange for a transfer or obligations when the debtor (a) was insolvent, (b) would be left with unreasonably small capital, (c) was unable to pay its debts as they came due because of the transfer or (d) made the transfer to an insider under an employment contract outside the ordinary course of business.

**4. Tips.**

**a. Preference proofing.** Nothing is “preference proof” but you can bolster a client’s position in settlements and contract (or amendments) by including statements by the potential debtor that he/she/it is solvent, the debt is not antecedent, the creditor is providing new value and the transaction is in the ordinary course of business.



**b. Springing release.** If you are concerned about a prospective bankruptcy, provide that a release or the entire settlement is not effective until a set time which would be outside all relevant preference periods.

**c. Educate your client.** Clients usually have a clue that the debtor may “be going down” or filing for bankruptcy based on performance or even discussions with the client. Letting your client know ahead of time that they should look at strategies to bolster their position *before* that actually happens can mean the client keeps the money it receives. For example, a seller in an ongoing relationship may want to switch to cash on delivery of goods rather than payment on account.

**d. Negotiate.** Trustees are generally willing to negotiate preference claim and allow a material discount. From the trustee’s perspective, the costs and risks of litigation discounts the value of the preference. This is particularly true when the trustee is trying to administer many preference claims in a large bankruptcy case.

**c. File claim.** If your client has to return money or property as a result of a preference or fraudulent transfer, the client can file a proof of claim for that amount. The deadline for doing so is short – 30 days from the date of the judgment for recovery (in a settlement, from the date of the order approving the settlement). Bankr. Rule 3002(c)(3). Watch for provisions in settlements drafted by trustees which waive the right to file such a claim.

## **E. Claims**

The claims process in bankruptcy allows creditors to share in the distribution of the non-exempt assets of the estate according to class of creditor and statutory priorities. While there are limited exceptions, a creditor generally must file a timely proof of claim to partake in any distributions from the bankruptcy estate. If the trustee designates a case as “no asset,” there will be no distribution and thus no opportunity to file a claim.

### **1. What is it?**

The Code defines a claim broadly as:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; **or**

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured. 11 U.S.C. § 101(5).

In short, a claim is a right to payment, whether or not it is disputed, contingent or liquidated. Under the Code, a “debt” means liability on a claim. 11 U.S.C. § 101(12).

## 2. Should I file a claim?

Here are a few things to consider:

- Filing a proof of claim may be the only way a creditor can seek payment from a debtor after the debtor files for bankruptcy. So, filing a claim is usually worth the time and effort.
- Filing a proof of claim subjects the creditor to the jurisdiction of the bankruptcy court – a result you want to think about when the debtor has possible counterclaims and has filed in a far-away jurisdiction.

## 3. Filing a Proof of Claim (“POC”).

- a. Docket deadline to file claim.** If there are assets in the bankruptcy, all creditors listed by the debtor will receive a notice from the court stating the deadlines for filing proof of claim. This is known as the “**claims bar date.**” The notice may list two dates – one for governmental entities and one for all other creditors – note the difference. The failure to timely file a claim can result in not receiving any eventual distribution.
- b. Complete the form.** Official Bankruptcy Form B10 (available through links on the Oregon Bankruptcy Court website (<http://www.orb.uscourts.gov/>) should be used in filing your claim. The form is a fillable pdf. Underlying documents (redacted for personal information) supporting the claim should be included as an attachment. Alternatively, a summary may be prepared and attached.
- c. Form submitted under penalty of perjury.** The person signing the proof of claim form does so under penalty of perjury. As a matter of practice, the client creditor or representative should verify and sign the proof of claim. Signature of the proof of claim by the creditor’s attorney may waive the attorney client privilege as to communications regarding the claim, because the attorney is attesting to personal knowledge of the facts in the proof of claim. *See In re Rodriguez*, 2013 WL 2450925 (Bankr. S.D. Tex. 2013).
- d. Filing.** The notice of the claims bar date contains instructions for filing a proof of claim. In large corporate bankruptcy cases, a third party may be administering claims filing. For most bankruptcies, claims are filed with the court. In Oregon, clients can file electronically through the “EPOC” system which is accessible through the Oregon Bankruptcy Court website (<http://www.orb.uscourts.gov/>) or by an attorney admitted to practice in the bankruptcy court in which the claim is being filed.

## 4. Will the claim be paid?

Whether or not a claim will be paid depends on a variety of issues, including the amount of assets in the estate, the priority of the claim and the priority of other claims and whether the debtor disputes the claim by filing an objection. Sometimes payment on a claim takes several years.

## 5. Tips.

- a. **Educate your client.** Make sure your client knows not to simply recycle or toss aside bankruptcy notices. Failing to docket and meet a claims bar date can make the difference in whether not the client gets paid.
- b. **Reserve rights.** In an attachment or on the POC form, reserve the right to amend, supplement or modify the claim or add additional claims.
- c. **Cost an issue?** While preparing and filing a proof of claim involves legal issues, your client may be hesitant to pay your fees to prepare something that may never result in any benefit to the client. The EPOC system allows creditors to directly file their own claims. EPOC has online guidelines for filing.
- d. **Service.** Though it is not required, serve the trustee and debtor with your proof of claim. Timely service on the debtor and the trustee may be sufficient to create an “informal” proof of claim, should something go wrong with the original filing.
- e. **Missed the deadline?** Even if your client misses the deadline, file a proof of claim. The claim may not be rejected. And, if there are sufficient funds, the claim may be paid anyway. You may have an argument that you filed an informal proof of claim.
- f. **Selling claims.** In large bankruptcies, creditors often receive offers to purchase their claims. **Read the fine print.** Often, these offers have draconian terms such as requiring that the selling party pay for the defense of any objection to the claim and return the sale price should the claim be rejected.

# BANKRUPTCY FOR THE NON-BANKRUPTCY LAWYER

## COERS MITCHELL LAW LLC

Christine Coers-Mitchell  
Johnston Mitchell

## AGENDA

- **Overview of Bankruptcy.**
  - Underlying policies.
  - Source of law.
  - Types of bankruptcy.
- **Speaking Bankruptcy.**
  - Automatic stay.
  - Discharge.
  - Claim and debt.
  - Property of estate.
  - Avoidance.
  - Strong arm powers.

## Underlying Policies?

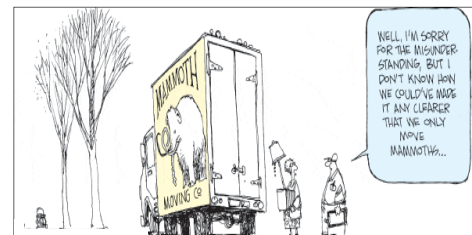
- **Two main policies.**
  - Policy of “fresh start.”
  - Policy of equal treatment of similarly situated creditors.
- **Preference for reorganization.**
  - Chapter 11.
  - Chapter 12.
  - Chapter 13.

## Source of Bankruptcy Law

- **Federal law.**
  - Bankruptcy Code.
  - Bankruptcy Rules.
- **Interplay with state law.**
  - Property rights typically determined by state law.
- **Statutory based.**
  - United States Bankruptcy Code — Title 11 of United States Code.
- **Rule based.**
  - Federal Rules of Bankruptcy Procedure.
  - Local District Court Rules.
  - Local Bankruptcy Rules.

## Types of Bankruptcies

- **Liquidation.**
  - Chapter 7.
  - Trustee collects nonexempt assets and distributes to creditors.
  - A debtor is discharged of most types of debt.
  - Most common type of bankruptcy.
- **Reorganization.**
  - Retain assets and creditors look to future income.
  - Chapter 11—entity and individual.
  - Chapter 13—individual wage earner.
  - Chapter 12—family farmer.



## Bankruptcy Litigation Terms

- Bankruptcy Case or “Main Case” – the umbrella.
  - Bankruptcy Rule 2004.
- Adversary Proceeding – Bankruptcy Rule 7001.
- Contested Matter – Bankruptcy Rule 9014.

## The Automatic Stay

- Helps a debtor get a “fresh start” by providing breathing time to reorganize or relief to Chapter 7 debtor.
- Helps make sure creditors are treated equally by freezing the status quo and giving trustee protection necessary to administer assets.
- Extremely broad – *e.g.*, applies to all entities.

## Scope of the Stay

- Arises immediately.
- Broadly prohibits:
  - Commencement or continuation of any litigation against debtor or estate property.
  - Enforcement of judgment against debtor or estate.
  - Act to obtain estate property or property from the estate.
  - Act to collect, assess or recover prebankruptcy claim.
- 28 exceptions:
  - Withholding income to pay domestic support.
  - Intercept of tax refund to pay domestic support.
  - Perfection of security interest.
  - Continue unlawful detainer action if judgment obtained before filing.

## Stay Tips

- Verify bankruptcy was filed and investigate background.
  - Prior bankruptcy.
- Suspend litigation.
- Notify court.
- Request relief from stay – often sooner better than later.



## Discharge Injunction

- Enjoins any act to collect on a debt that arose prior to bankruptcy filing.
- Eliminates personal liability.
- Does not eliminate debt.
- Nondischargeable debts.
  - Only for individuals in Chapters 7 and 13.
  - Section 523(a).
- Denial of discharge.
- Chapter 13's discharge – “semi-super.”

## Why do you care?

- Insurer.
- Guarantor.
- Secured debt.
- Litigating nondischargeable claim\debt.
- Settling nondischargeable claim\debt.



## Claim and Debt

- **“Claim”** – any right to payment or right to equitable remedy that gives rise to right to payment.
  - Pre-petition, post-petition.
  - Secured, unsecured.
  - Priority, nonpriority.
- **“Debt”** – “liability on a claim.”

## Why do you care?

- Distribution from bankruptcy is made to a creditor – holder of a claim.
  - Need to file a proof of claim.
  - Attorney fees.
  - Deadlines.
  - Benefits.
  - Risks.
- Discharge of “debt.”

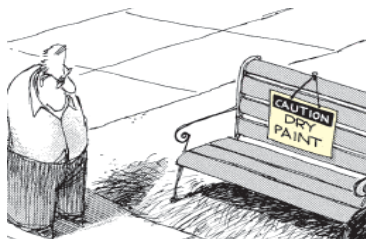


## Property of the Estate

- Filing of bankruptcy creates an estate.
- General policy is to bring in all interests of a debtor in any conceivable property.
  - Contract rights.
  - Causes of action.
  - Other intangible property.
- Look to state law to determine a debtor’s interest.
- Exceptions – *e.g.*, ERISA plan.

## Why do you care?

- Automatic stay.
- A trustee may use, sell or lease property of estate.
- Turnover.
- Avoid and recover transfers.



## Preferences

- Transfer of a debtor’s property.
- To or for the benefit of a creditor.
- On account of an antecedent debt owed before the transfer.
- Made while a debtor was insolvent.
- Made during preference period.
- Allows a creditor to receive more than the creditor would receive in hypothetical Chapter 7.

## Three Main Defenses

- **Subsequent new value**
  - To extent creditor gives new value extended after the transfer.
  - New value remains unpaid (by debtor).
- **Contemporaneous exchange** – C.O.D. defense
  - Transfer intended to be contemporaneous.
  - Transfer was in fact contemporaneous.
  - New value given.
- **Ordinary course defense**
  - The debt was incurred in the ordinary course of business.
  - (a) transfer was made in the ordinary course of business or  
(b) transfer was made according to the ordinary business terms.

## Preference Proofing?

- Using recitals.
  - Solvent.
  - Antecedent debt.
  - New value.
  - Ordinary course transaction.
- Springing release.
- Document new value and ordinary course transaction.

## Other Avoidance Powers

- Fraudulent conveyances (§ 548).
  - Avoidance of transactions made with actual intent to hinder, delay or defraud creditors.
  - Avoidance of transactions if made for less than reasonably equivalent value.
- Postpetition transfers not authorized by court or Bankruptcy Code (§ 549).

## “Strong-Arm” Powers

- Section 544 bestows on a trustee different hypothetical standings.
- Hypothetical bona fide purchaser of real property.
- Power of any unsecured creditor to avoid transfer under state law.

## A COUPLE OF TAKE AWAYS

- You can plan ahead and minimize the effect of a bankruptcy filing.
- A bankruptcy filing can be good news.

