Business Law and Bankruptcy

Class 13

Chapter 11: Reorganization

- This is the choice for a company that wants to stay in business.
- The debtor will usually keep the property during the proceeding (“debtor in possession”)

- Steps:
  1. The reorganization plan: For the first 120 days after filing, only the debtor may file a plan for reorganization. After that, the creditor can submit a plan as well.
  2. The creditors are divided into groups that will be paid off in various ways by a plan.
     - Example: “Employees will get ¾ of their wages over the next 3 years, and suppliers will get ½ of their money now. ‘Employees’ is one class, and ‘suppliers’ is another.”

Chapter 11: Reorganization (cont.)

- Steps (cont.):
  3. The creditors for committees for each class can negotiate on behalf of the class. If a committee doesn't like the plan, it can negotiate for it to be changed.
  4. The plan must be approved:
     - Only classes who are "impaired" in some way by the plan have to approve the plan.
     - A plan is approved by a class if half of the members and 2/3 of the debt interest within the class approve the plan.
     - If all classes approve the plan, the plan is approved.
     - If one class approves a plan, the court can force everyone to accept the plan ("cram down"), but only if the plan is fair to all classes.
  5. If no plan is approved, eventually there will be a motion to convert it into Chapter 7 liquidation.
  6. Discharge of remaining debts (the debtor must pay out the money called for by the approved plan)

Chapter 13: Debt Adjustment

- Only for individuals, only voluntary, and not available for very large debts.
- Used by individuals with jobs who can pay all or most of their debts eventually, just not as they come due.
- Debtor keeps possession of property.
- Can be converted into a Chapter 7, or a Chapter 7 can be converted into a Chapter 13, but only with the debtor’s permission.

Steps in a Chapter 13 Proceeding

1. Debtor files a plan and begins making payments under that plan (even though it has not been approved yet).
2. Plan is submitted to each creditor for negotiation and, hopefully, approval. The plan must call for the payment of debts (or most of them) over the course of 3 years.
3. Creditors approve the plan:
    - When each creditor approves the plan, it is accepted as to that creditor.
    - Those who reject the plan can continue negotiating, or try to force the debtor into Chapter 7.
    - A judge can force a plan on a creditor if the plan is fair, and s/he will get paid off, or if the debtor really is paying all he can, based on his income.
4. Modification of the plan: Courts can allow reasonable modifications of the plan upon a request by the debtor.
5. Discharge: Court may even allow a “hardship discharge” if, through no fault of the debtor, the plan cannot be completed.

QUIZ TIME!

If A Debtor Can't Make Plan Payments

- If for some reason a debtor cannot finish a Chapter 13 repayment plan (for example, the debtor loses his/her job six months into the plan and can't keep up the payments), the bankruptcy trustee may modify the plan. The trustee may:
  - give the debtor a grace period, if the problem looks temporary,
  - reduce the debtor's total monthly payments, or
  - extend the repayment period.
- If it's clear that there's no way the debtor will be able to complete the plan because of circumstances beyond his/her control, the court might let the debtor discharge his/her debts on the basis of hardship.
  - Examples of hardship would be a sudden plant closing in a one-factory town or a debilitating illness.

If A Debtor Can't Make Plan Payments (cont.)

- If the bankruptcy court won't let the debtor modify the plan or give the debtor a hardship discharge, the debtor can:
  - convert to a Chapter 7 bankruptcy, unless s/he received a Chapter 7 bankruptcy discharge within the last eight years or a Chapter 13 bankruptcy discharge within the last six years, or
  - ask the bankruptcy court to dismiss his/her Chapter 13 bankruptcy case.
    - The debtor would still owe his/her debts. However, any payments s/he made during the plan would be deducted from those debts. On the flip side, his/her creditors will be able to add on interest they did not charge while his/her Chapter 13 case was pending.

How the New Bankruptcy Law Affects Chapter 13

- Under the old rules, people who filed under Chapter 13 had to devote all of their disposable income – what they had left after paying their actual living expenses – to their repayment plan.

- The new law adds a wrinkle to this equation: Although Chapter 13 filers still have to hand over all of their disposable income, they have to calculate their disposable income using **allowed expense amounts dictated by the IRS** – not their actual expenses – if their income is higher than the median in their state. These expenses are often lower than actual costs.

How the New Bankruptcy Law Affects Chapter 13 (cont.)

- These allowed expense amounts must be subtracted not from the filer's actual earnings each month, but from the filer's average income during the six months before filing.
  - This means that debtors may be required to pay a much larger amount of "disposable income" into their plan than they actually have to spare every month -- which, in turn, means that many more Chapter 13 plans will fail.
- Like Chapter 7 filers, Chapter 13 filers must undergo requisite credit counseling in order to be able to file.

Discharge

- The is the main point of a bankruptcy proceeding; when the court grants the bankruptcy discharge and thus releases the debtor for all existing debts and gives the debtor a fresh start
  - In a Chapter 7, this means wiping out all debt
  - In a Chapter 11 or 13, this means wiping out all debts except for whatever is called for by the plan

Non-Dischargeable Debts

- Certain taxes (such taxes for which a return wasn't filed or filed late, or for which a return was filed fraudulently).
- Debts for property received by false pretenses or actual fraud, or by use of a statement in writing that was intentionally false that a creditor relied on.
- Consumer debts that are incurred within 60 days before order for relief, are owed to a single creditor, and are for more than $1,000 of luxury goods or services, or consumer cash advances that total more than $1,000, also obtained within 60 days before the order.

Non-Dischargeable Debts (cont.)

- Debts that aren't listed in debtor's schedule of debts filed with the court.
- Debts arising from Debtor's fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny.
- Alimony, maintenance or child support if they arose pursuant to a divorce or separation.
- Willful and malicious injury caused to someone or their property.

Non-Dischargeable Debts (cont.)

- Fines or penalties can’t be discharged unless they’re compensation for actual loss by a creditor. A non-compensatory tax penalty or any tax penalty over 3 years old can’t be discharged.
- Student loans, or debts to fund education unless it became due 7 years before the filing or such a failure to discharge would cause undue hardship to the debtor.
- Debts from torts committed while drunk or drugged driving.