


BANKRUPTCY BASICS



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BANKRUPTCY DEFINED

- Generally, a debtor declares bankruptcy to obtain relief from debt, and this is accomplished either through a discharge of the debt or through a restructuring of the debt.
- When a debtor files a voluntary petition, his or her bankruptcy case commences.

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HISTORY OF BANKRUPTCY

- Bankruptcy was historically a creditor remedy, allowing creditors to seize all debtors assets and imprison the debtor until the remainder of the debts could be paid
- In 1700's, imprisonment was not as common and many debtors fled England for the United States
- The first bankruptcy Act in the U.S. was in 1800 and still provided only for creditor rights
- The first voluntary bankruptcy statutes in the U.S. were 1841 and 1867
- The system of bankruptcy courts was established by Congress in 1979

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## PURPOSES OF BANKRUPTCY

- Protection of creditors
  - Ensures that most creditors receive all or a portion of what is owed
  - Creditors may file “involuntary bankruptcy” against the debtor if there are enough creditors and debt
- Protection of debtor
  - Gives the debtor a fresh start by legally extinguishing debt but still requiring that they pay all or a portion of most of their debts

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## BANKRUPTCY JURISDICTION

- Federal Bankruptcy Court
- Division of Federal District Court
- Debtor must reside, be domiciled, have a place of business or own property in the United States

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## BANKRUPTCY VENUE

- For venue to be proper, the debtor must be domiciled, maintain residence, principal place of business or have principal assets in the filing venue for 180 immediately prior to filing
- Some states have favorable laws regarding exempt assets and are attractive venues
- Some Federal District courts have been termed “debtor friendly” and are attractive venues
- Any party in interest may petition to have the case removed from one venue and heard in another proper venue in the interests of justice or for the convenience of the parties

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## BANKRUPTCY LAWS

- USCA
  - Title 11 of the USCA
- MCLA
  - 600.5451 – defines most property that is exempt from levy
  - There are many other like statutes concerning exempt assets like pensions, insurance policies and public benefits

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## BANKRUPTCY DEBT

- Secured
  - Debts with collateral
    - Real property
    - Vehicle
    - Other titled property
- Unsecured
  - Most other debt
- Priority
  - Debts that the legislature considered important enough that it should not be dischargeable
    - Support
    - Criminal restitution
    - Most taxes

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## TYPES OF BANKRUPTCY

- Chapter 7
  - Basic liquidation for individuals and businesses
- Chapter 11
  - Available to railroads, businesses and individuals with significant assets which allows rehabilitation or reorganization while company continues to do business
- Chapter 13
  - Basic reorganization or rehabilitation for individuals with regular income

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## TYPES OF BANKRUPTCY

- Chapter 9
  - Bankruptcy for municipalities to resolve municipal debt
- Chapter 12
  - Bankruptcy rehabilitation for family farmers
- Chapter 15
  - Usually international cases to help foreign debtors to clear debts.

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## 2005 AMENDMENTS

- Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA)
  - Effective October 17, 2005
  - Forcefully advocated by consumer lenders
  - Forcefully opposed by many consumer advocates, bankruptcy academics, bankruptcy judges, and bankruptcy lawyers
  - Americans who have the ability to pay will be required to pay back at least a portion of their debts
  - Those below state's median income will not be required to pay back their debts
  - Made it more difficult for serial filers to abuse bankruptcy protections
  - Debtors seeking to erase all debts will now have to wait eight years from their last bankruptcy before they can file again (Chapter 7)

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## BANKRUPTCY STATISTICS

- 2001
  - Total filings = 1,492,129
    - Chapter 7 = 1,054,179
    - Chapter 13 = 425,292
  - Michigan total = 46,826
    - 3.1% of total
- 2004 – 2005 up to new legislation
  - Total filings = 1,782,643
    - Chapter 7 = 1,346,201
    - Chapter 13 = 429,316
  - Michigan total = 75,760
    - 4.2% of total

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## BANKRUPTCY STATISTICS

- 2005 – 2006 – after new legislation
  - Total filings = 1,112,542
    - Chapter 7 = 833,147
    - Chapter 13 = 272,937
  - Michigan total = 53,354
    - 4.8% of total
- 2008
  - Total filings = 1,042,993
    - Chapter 7 = 679,982
    - Chapter 13 = 353,828
  - Michigan total = 53,340
    - 5.1% of total

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## TYPES OF BANKRUPTCY

### CHAPTER 7:

- Usually results in discharge (cancellation) of most unsecured debts
- Allows the filer to keep most of their property
- Usually takes about 3 months
- Will generally have little impact on secured debts
- Non-exempt assets may be sold to satisfy debt
- Filing precludes collection of most debt by creditors
- Debtor can only receive one Chapter 7 discharge every 8 years

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## TYPES OF BANKRUPTCY

### CHAPTER 7:

- Upon filing most property becomes part of the bankruptcy estate
  - May include property sold for less than its value in the previous two years
  - May include property purchased within 6 months after filing
  - Includes a reasonable home and vehicle only if the debtor is not current on the note and/or if the have significant non-exempt equity

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## TYPES OF BANKRUPTCY

### CHAPTER 13:

- Does not result in a complete discharge of debts, but allows payment of some or all of what is owed over time (usually 3-5 years depending on amount of income and value of assets)
- The plan must show sufficient income to pay a reasonable amount of the debt to be confirmed by the judge
- Debtor is not required to give up any property to the bankruptcy estate as long as payments are current
- Upon completion of the plan, the remainder of the debts are discharged
- Can be filed any time, but frequent filings can affect the Automatic Stay

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## MEANS TEST

- New in 2005 Amendments
- This determines whether the filer qualifies for Chapter 7 or Chapter 13
- Based on the filer's income relative to the state median income and a debt/income ratio
- If below the median income, the filer can file Chapter 7 or propose a three year plan under Chapter 13
- If above the median income, the filer must show insufficient funds to support a Chapter 13 plan or must propose a five year plan under Chapter 13

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## CREDIT COUNSELING

- New in 2005 Amendments
- Prior to filing the filer must complete a two hour credit counseling session which is designed to determine if there is another feasible way to handle the debt load without filing for bankruptcy.

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## BUDGET COUNSELING

- New in 2005 Amendments
- Prior to discharge, the bankrupt must complete a two hour budget management course which is designed to educate the individual and preclude future bankruptcies.

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## AUTOMATIC STAY

- Acts as an injunction prohibiting collection efforts of most creditors against the filer directly
- Becomes effective when the action is filed
- Any collection efforts must proceed through Bankruptcy Court
- Designed to protect debtors from creditors seeking to seize their assets
- Designed to protect creditors by preventing one creditor from obtaining an excessive share of the debtor's assets

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## AUTOMATIC STAY

- Any acts in violation of the automatic stay are void
- Violation includes these penalties:
  - Contempt of court
  - A cause of action by the debtor against the creditor to recover associated costs
  - A cause of action by other creditors against the violating creditor to recover associated costs
- Terminates if a creditor is granted relief from stay by court, when subject property is no longer property of the estate, the case is closed, dismissed or debts are discharged

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## AUTOMATIC STAY

- Types of collection actions subject to the automatic stay:
  - Credit cards
  - medical debts
  - attorney fees
  - overpayment reimbursement of public benefits
  - debts related to criminal proceedings
  - most post-filing landlord/tenant actions
  - Foreclosures
  - provision of utilities
  - IRS actions to seize income or property
  - divorce action property division (stay often lifted at request of a party)

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## AUTOMATIC STAY

- Automatic stay does not apply to:
  - collection of current child/spousal support
  - Collection of child/spousal support arrears
  - Determination of custody and parenting time
  - Lawsuits to establish paternity
  - Actions to modify child/spousal support
  - Personal protection order proceedings
  - Withholding of income to collect support
  - Reporting of overdue support to credit bureaus
  - Tax offset actions to pay arrears
  - License suspensions as support enforcement technique
  - Prosecution for criminal activity

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## MEETING OF CREDITORS

- A meeting attended by the debtor, trustee and creditors
- Debtor affirms under oath the truthfulness and accuracy of pleadings regarding assets, liabilities, recent transactions and means test determination regarding Chapter 7/13 filing
- Trustee and creditors may also ask questions about these issues which the debtor must answer under oath

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DISPOSABLE INCOME

- Currently defined as net income less these amounts:
  - That needed for maintenance and support of the NCP or dependents
  - That needed for post petition domestic relations obligations
  - That needed for the payment of expenses necessary for continue, preserve and operate the debtor's business

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FRAUDULENT CONVEYANCES

- Fraudulent conveyances or preferential transfers are those that are made to conceal assets or exclude assets from the bankruptcy estate
- These transfers are usually void
- Payments made toward domestic support obligations are not voided regardless of when the payment was made and the amount

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PRIORITY OF DEBTS

- The priority in which unsecured debts are paid in bankruptcy, each priority claim must be paid before the next in priority
- Each type of debt given the same priority shares payments pro rata
- Secured claims are paid by liquidation of the asset

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## PRIORITY OF DEBTS

- Priority debts:
  - Claims for debts to spouse or children for court ordered support
  - Administrative expenses of the bankruptcy
  - Unsecured, post petition claims
  - Wage claims of employees up to \$10,000 per claim
  - Contributions to employee benefit plans up to \$10,000/employee
  - Claims of farmers and fishermen against debtors operating storage or processing facilities
  - Layaway claims of individuals who didn't get the item sold
  - Recent income, sales, employment or gross receipts taxes

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## EXEMPT PROPERTY

- In Michigan, the following property is exempt from seizure to satisfy debts:
  - Tenancy by Entireties property if only one spouse files
  - Real property on one lot worth up to \$34,450
  - Disability, mutual life or health benefits
  - Employer sponsored life insurance or trust fund
  - Most life, endowment or annuity proceeds
  - Business partnership property
  - Most tax exempt retirement accounts and IRA contributions (except if made within 120 days of filing)

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## EXEMPT PROPERTY

- In Michigan, the following property is exempt from seizure to satisfy debts:
  - Appliances, utensils, books, furniture & household goods up to \$525 each or \$3,450 total value
  - Burial plots
  - Church pew/seat for entire family up to \$575
  - Clothing and family pictures
  - Crops, animals, feed up to \$2,300 value
  - One motor vehicle worth up to \$3,175
  - Computer and accessories worth up to \$575
  - Household pets worth up to \$575
  - Professionally prescribed health aids
  - Six months worth of food and fuel

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## EXEMPT PROPERTY

- In Michigan, the following property is exempt from seizure to satisfy debts:
  - Crime victims compensation
  - Social welfare benefits
  - Unemployment compensation
  - Workers compensation
  - VA benefits for Korea/Vietnam/WWII veterans
  - Tools of trade up to \$2,300 value
  - Some earned but unpaid wages

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## DISCHARGE OF DEBTS

- These types of debts will usually be discharged in bankruptcy:
  - Credit card
  - Medical bills
  - Most legal money judgments
  - Most obligations under leases and contracts
  - Most personal loans and promissory notes
  - Many debts that are also covered by liens that remain
  - Most other debts that are not specifically excluded

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## DISCHARGE OF DEBTS

- These types of domestic debts are not discharged:
  - Court ordered child/spousal support obligations (amounts owed to a governmental agency are not required to be paid during a 13 bankruptcy but are still owed after completion of the plan)
  - Other ordered debts in the nature of support
  - Other ordered domestic debts or obligations (7 only)
    - debtor's obligation to pay property settlement payments to ex-spouse
    - obligations to pay third parties (credit card debt or house payments)
    - obligations to hold ex-spouse harmless if he or she has to pay debts that the bankrupt spouse should have paid
    - liens on property affecting a spousal debt if secured by lien.

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## DISCHARGE OF DEBTS

- These types of debts are not discharged in bankruptcy:
  - Fines, penalties and restitution
  - Fraudulent income tax debt
  - Property tax debt
  - Debt incurred to pay nondischargeable taxes (7 only)
  - Court filing fees (7 only)

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## DISCHARGE OF DEBTS

- These types of debts are not discharged in bankruptcy:
  - Debts resulting from an injury or death caused by the filer while driving intoxicated
  - Condominium/Homeowner fees
  - Debts for loans from a retirement plan (7 only)
  - Student loans (unless undue hardship = poverty + good faith effort)
  - Some income taxes
  - Some fraudulent transactions if the creditor properly objects to discharge
  - Debts arising from debtor's willful and malicious acts (crimes)
  - Debts arising from breach of fiduciary duty
  - Debts to creditors not listed in bankruptcy for discharge

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## BANKRUPTCY TRUSTEE

- Local attorney or non-lawyer who is knowledgeable about bankruptcy and the local court's practices
- The Trustee oversees the bankruptcy process, collects/sells property to satisfy debts and ensures that payments are made
- Required to notify the payee of support and the state child support agency that the debtor has filed bankruptcy

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## BANKRUPTCY TRUSTEE

- Notice to payee of support must include:
  - Availability of IV-D services to collect support
  - Address and telephone number of IV-D agency
  - Granting of discharge of debt
  - Last known address of debtor's employer
  - Name of each creditor that holds a non-discharged claim

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## BANKRUPTCY TRUSTEE

- Notice to IV-D agency must include:
  - Payee's name, address, phone number
  - Granting of discharge of debt
  - Debtor's last known address
  - Last known address of debtor's employer
  - Name of each creditor that holds a non-discharged claim
  - All notices, pleadings and correspondence

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## RELEVANT AGENCY DUTIES

- OCS:
  - Determines all counties that have a case for the NCP/debtor by searching CLST
  - Logs receipt of documents from the Trustee in the Bankruptcy Notices Log with the following information:
    - Name of each county where the debtor has a case
    - Debtor's name
    - Docket numbers for each case
    - The date OCS received the notice

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## RELEVANT AGENCY DUTIES

- OCS:
  - Mails all bankruptcy information to the Bankruptcy Contact person at the Friend of the Court in any county in which the debtor has an open support case
  - Completes Bankruptcy Notices Log with the following information:
    - The date documents were mailed to the FOC
    - OCS personnel initials indicating task is complete
  - OCS will not retain copies and does not make notes in NOTE screen
  - Questions may be addressed by calling 517/373-9202

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## RELEVANT AGENCY DUTIES

- FOC – Enforcement
  - May continue to collect support and enforce payments of support using the following enforcement actions:
    - Income withholding
    - License suspension
    - Credit reporting
    - Tax offset
    - Medical support enforcement
    - Passport denial
    - Collection of support from property not a part of bankruptcy estate through liens

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## RELEVANT AGENCY DUTIES

- FOC – Enforcement
  - Order to show cause prior to discharge should be for post petition unpaid support only
  - This amount is easily determined on SLOG
  - Locally print and manually change the arrears balance on the Motion and Order to Show Cause form
  - Lack of payments may result in inability to confirm a Chapter 13 plan or discharge debts
  - Should respond to a Notice of Meeting of Creditors and indicate that support amounts are not dischargeable in bankruptcy
  - Should not need to attend the Meeting of Creditors

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## RELEVANT AGENCY DUTIES

- FOC – Enforcement
  - The custodial parent may be frustrated by the non-custodial parent having filed for bankruptcy
  - The custodial parent may be jointly liable or have been legally responsible for some of the debts being compromised and may receive calls from creditors regarding the debt
  - The FOC should refrain from advising parties on these matters
  - The FOC need not send copies of notices from Trustee to MiSDU

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## RELEVANT AGENCY DUTIES

- FOC – MiCSES
  - DEMO screen
    - If bankruptcy status is set to N or blank, set to R
      - Allows enforcement remedies to continue
    - If bankruptcy status set to Y, set to N then set to R
      - Allows enforcement remedies to continue
    - Enter petition filing date in Petition File DT field
    - Enter a future date in Petition End DT field
      - High end – 12/31/9999; or
      - A tickler date for review of case
    - Select proper bankruptcy type in drop down

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## RELEVANT AGENCY DUTIES

- FOC – MiCSES will do the following when Bankruptcy status is set to R
  - ADLV
    - Allow pre-petition activity chain to continue
    - Prevent post-petition initiation of remedy
  - SCBW
    - Close pre-petition activity chain
    - Allow manual initiation of post-petition activity
  - The following remedies will also be allowed
    - CRAR, tax offset, license suspension, NMSN, SCMI, SCMB
  - Restart IIWO and UNEM for current support only unless otherwise ordered for payment of arrears

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## RELEVANT AGENCY DUTIES

- FOC – MiCSES
  - NOTE screen
    - Enter a case note indicating that a bankruptcy petition was filed and the date
  - TAXI screen
    - Exclude payer from FIDM
    - Liens may remain but should not be levied against
  - ENFP screen
    - Close any open show cause chains
    - Move QDRO chain to RQDRO minor activity

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## RELEVANT AGENCY DUTIES

- FOC – MiCSES
  - Bench Warrants
    - OCS currently recommends recall of all child support related bench warrants to avoid any chance of violation of the automatic stay
    - If the matter is on the record, FOC should indicate to judge or referee that payer has filed for bankruptcy and the case is subject to automatic stay
    - FOC shall process the results of the show cause and bench warrants based on court's informed decision

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## RELEVANT AGENCY DUTIES

- FOC – MiCSES – When bankruptcy dismissed or discharged
  - DEMO screen
    - Set bankruptcy status to N
    - Enter the date the judge granted the discharge or dismissed the petition in the Petition End DT field

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## PRE 10-17-05 DIFFERENCES

- Priority of claims
  - Child support was 7<sup>th</sup> and only debts owed to spouse, former spouse or dependent children were included
  - Child support owed to the state did not have priority status but could not be discharged
- Confirmation/Discharge
  - Post-petition child support was not required to be paid before receiving a plan confirmation or discharge
- Automatic Stay
  - Only exemptions were for:
    - establishment of paternity
    - Establishment or modification of alimony, maintenance or support
    - Collection of support from property not in bankruptcy estate

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## PRE 10-17-05 DIFFERENCES

- Enforcement
  - Only remedy for collection was collecting child support from property that was not a part of the bankruptcy estate
  - All other enforcement actions to collect pre-petition arrears were subject to automatic stay
- Dischargeability
  - Child support owed to the family is not dischargeable
  - In some cases support assigned to the state was dischargeable
  - Support accrued during divorce action was only dischargeable if the NCP is unable to pay the debts or the benefit of discharge outweighed the detriment to the spouse, former spouse or child of the NCP

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## PRE 10-17-05 DIFFERENCES

- Preferential transfers
  - Only included child support, not expanded definition of domestic support obligation and all included types of payments
- Disposable income
  - Did not include amounts needed for domestic relations obligation that first became payable after filing of petition

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## PRE 10-17-05 DIFFERENCES

- Duties of Trustees
  - Trustees were not required to provide notice to IV-D staff of the bankruptcy action or inform the holder of the child support claim (custodial parent) of services provided by the IV-D agency

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## PRE 10-17-05 DIFFERENCES

- IV-D staff actions:
  - DEMO
    - Set Bankruptcy indicator to Y
    - Select bankruptcy type
    - Enter petition filing date
  - TAXI
    - Exempt NCP from tax offset, passport denial and FIDM
  - ENFP
    - Move QDRO chains to review
  - IIWO & UNEM
    - Staff must manually terminate IWN in arrears only cases

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## PRE 10-17-05 DIFFERENCES

- MiCSES will automatically:
  - Close ADLV, SCBW and CRAR chains
  - Recalculate employer (IIWO) and unemployment (UNEM) income withholding amounts to generate an income withholding notice (IWN) for current (post-petition) domestic support only
  - MiCSES will not recalculate an IWN in arrears only cases because arrears are not collectible

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