

# BANKRUPTCY AUDIO

David G. Epstein, George E. Allen Chair, University of Richmond Law

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## PART ONE: GENERAL

- I. Overview of this audio
  - A. Who?
  - B. When?
- II. Overview of bankruptcy
  - A. Why bankruptcy?
    - (1) What are the alternatives?
      - a. Individual creditor judicial action
      - b. Agreement binding only on participants
    - (2) Why do individuals file for bankruptcy?
    - (3) Why do businesses file for bankruptcy?
    - (4) Why do creditors “induce” their debtors to file for bankruptcy?

(5) In summary, three big differences between bankruptcy and state law alternatives

- a. Possibility of discharge
- b. Court approved restricting of debt binding on dissenting creditors
- c. Collective action

B. What is bankruptcy law?

(1) Title 11

- a. Chapters 1,3 and 5
- b. Chapters 7, 11 and 13
- c. Chapter 12 and 15

(2) Bankruptcy Rules

(3) Constitution

- a. Article 1 “enact uniform laws on the subject of Bankruptcies”
- b. Article 1 “no State . . . impairing the obligation of contracts”
- c. Fifth Amendment, “ deprived of . . . property without due process”

- (4) State law
  - a. No state bankruptcy laws
  - b. Federal bankruptcy law incorporates state laws such as
    - i. Exemption statutes
    - ii. UCC

(5) Case law

C. Who are the important bankruptcy people?

- (1) Debtor
- (2) Bankruptcy judge
- (3) United States trustee
- (4) Chapter 7 trustee
- (5) Chapter 13 trustee
- (6) Chapter 11 trustee
- (7) Chapter 11 debtor in possession
- (8) Creditors (also known as holders of claim)
  - a. Secured creditors (holders of secured claims)
  - b. Unsecured creditors (holder of unsecured claims)

(9) Chapter 11 UNSECURED creditors committee

(10) Chapter 11 “DIP lender”

D. What are the important documents?

(1) Bankruptcy petition

(2) Schedules

(3) Plan in 11 and 13

(4) DIP financing agreement in 11

E. Where does bankruptcy happen?

(1) Bankruptcy courts and their jurisdiction (politics and status)

a. 28 USC 1334 and grant of jurisdiction to “district court”

b. 28 USC 151 and bankruptcy court as “unit of district court”

c. 28 USC 157

A. “core proceedings” and final orders

B. Stern v. Marshall

C. Non-core proceedings and proposed findings of fact and conclusions of law

(2) Procedure in bankruptcy court

a. Adversary proceedings

b. Contested matter

F. How does bankruptcy happen? 301, 303

(1) Filing of a petition and “commencement of case”  
and “order for relief”

(2) Generally no requirement of judicial action

(3) No requirement of insolvency

(4) Involuntary petitions and “generally not paying .  
. . debts”

III. Three important bankruptcy policies

#1 Fresh start

#2 Equality of distribution

#3 Protection of creditors’ property interest

IV. Five important concepts

#1 Discharge (3 questions)

### What is a discharge?

Destroys “personal liability”

Does not destroy debt which is important to guarantors and insurers and

Does not destroy mortgages and security interests

### Who gets a discharge?

7

11

13

### What debts are affected?

Time debt incurred

Nature of debt

Debtor’s bad acts in connection with debt

## #2 Claims (3 questions)

### What are claims? 101(5)

- i. “right to payment”
- ii. “contingent”,  
“unmatured”, “disputed”

E.g., On 1/10, D Co., borrows \$100,000 from C, payable over 36 months. G guarantees D Co 's payment. On 7/7, D Co. files for bankruptcy/

What are types of claims?

- i. Secured, 506(a)
  - a. Right of setoff
  - b. Lien on property of the debtor

E.g., D owes M \$100,000. M has a first mortgage on Redacre which is valued at \$75,000.

- ii. Unsecured
  - a. Priority, 507(a)(1)-8 and 503
    - i. 7 paid first
    - ii. 11 and 13 paid
  - b. General

What is bankruptcy significance of having a claim?

- I. discharge

II. distribution in  
bankruptcy case

#3 Property of the estate, 541(a)(1), (6), 1306 (3  
questions)

A. When?

“commencement of a case”

B. Why important?

i. In 7

ii. In 11 and 1

C. What?

i. “interests of the debtor in  
property”

E.g., D and X each own 50% interest in Redacre

E.g., D owns Redacre but First Bank has mortgage on Redacre to  
secure its \$100,000 debt

ii. “as of the commencement of  
the case”

E.g., D finds lottery ticket day after filing for bankruptcy and . . .



E.g., D files for 7 bankruptcy on February 28. D paid wages for March work on March 30.

E.g., D Furniture Store files for 11 bankruptcy on February 28. D sells sofa on March 1.

#### #4 AUTOMATIC Stay, 362 (4 questions)

When does automatic stay become effective?

What is the effect of automatic stay? 362(a), (b)

Protects debtor, property of the estate, property of the debtor from post-petition actions by holders of pre-petitions claims

When does automatic stay end? 362©

How can creditor obtain relief from automatic stay?

362(d)

- i. Form of filing by debtor  
–“request”/motion
- ii. Forms of relief

- Terminating, annulling,  
modifying, conditioning
- iii. Grounds for relief
    - a. “no equity” AND “not necessary to an effective reorganization”
    - b. “Cause,” section 362(d)(1)
    - c. “lack of adequate protection of interest in property,” section 362(d)(1)

#5 Adequate protection of an interest in property (2 questions)

A. What is adequately protected?

1. Creditor’s interest in property
2. Not creditor’s right to payment

Look for depreciation, drop in value  
of collateral

B. How can a debtor provide adequate  
protection?

1. Cash payment
2. New collateral
3. “Indubitable equivalent” such as  
equity cushion

E.g., debt of 100, collateral worth 300

E.g., debt of 100 collateral worth 80 that is holding its value

**PART TWO – CHAPTER 7 CASES**

V. Chapter 7

- (a) Overview of what happens in a Chapter 7 case
  - i. Petition and schedule
  - ii. 7 trustee sells property of estate
  - iii. 7 trustee distributes net sale proceeds

iv. discharge

(b) Who can be a Chapter 7 debtor?

i. Business entities

ii. Individuals

1. Husband and wife and joint petition, 302

2. Passing the “Means test”,

707(b)(“individual debtor”, “primarily  
consumer debts”)

a. “Current” [6 months before petition]  
monthly income”

b. “Median income”

c. Disposable income

3. No requirement of insolvency

(c) Role of Debtor’s attorney

(d) Role of Chapter 7 trustee

(e) Role of bankruptcy judge

(f) Cost of 7 to debtors

i. Filing fee

ii. Attorneys’ fee

- iii. Loss of property of the estate
- (g) Individual debtor's exempt property
  - i. What law determines what property is exempt?
    1. 522(d)
    2. Opt out, 522(b) ("State law . . . does not so authorize")
    3. 730 day test
    4. 180 days before the 730 days test
  - ii. What happens to exempt property at the end of the bankruptcy case?
    1. Generally
    2. Exceptions
      - a. Alimony, child support
      - b. Waivers generally ineffective
      - c. Liens generally effective
- (h) What happens to secured claims
  - i. Abandonment, 554
  - ii. Redemption, 722

1. What property?
  - a. Personal
  - b. Exempt
  - c. “personal, family, or household use”

2. What payment?
  - a. Value of collateral, “allowed secured claim”
  - b. Cash, “time of redemption”

iii. Reaffirmation, 524

1. Agreement
2. Post-petition/pre-discharge
3. Representation/court approval

(i) Distribution to unsecured creditors of property of the estate, 726

- i. 507 priority claims
- ii. “pro rata”

E.g., 1000 remaining after paying 507 and 20,000 of unsecured claims

(j) Discharge

- i. Denial of discharge because of 727 objection
  - 1. Based on debtor's prebankruptcy actions
    - a. 727(a)(8)(7 discharge eight years)
    - b. 727(a)(2)("intent to defraud" one year)
  - 2. Based on debtor's bankruptcy actions ("false oath")
- ii. Debts not covered by discharge 523
  - 1. Post-petition
  - 2. Unscheduled
  - 3. Kind of debt
    - a. Taxes, 523(a)(1)
    - b. Domestic support obligations, 523(a)(5), (15)
    - c. Educational loans, 523(a)(8)
      - "undue hardship"
  - 4. Debtor's conduct
    - a. "false representation", 523(a)(2)

b. “willful and malicious injury”,

523(a)(6)

iii. Effect of discharge (REVIEW)

1. On mortgages and secured interests

2. On guarantors or insurers

(k) Review

i. What happens to cars in Chapter 7 cases?

ii. What happens to houses in Chapter 7 cases?

### **PART THREE: CHAPTER 13 CASES**

VI. Chapter 13 cases

a. Overview of what happens in 13 case

i. Petition FILED BY INDIVIDUAL DEBTOR, schedule  
and plan

ii. Reviewed by 13 trustee

iii. Confirmed by judge



- iv. Plan payments from future income administered by 13
- v. IF PLAN COMPLETED, discharge
- b. Who can be a Chapter 13 debtor?
  - i. Individual
  - ii. Regular income
  - iii. Debt limits
- c. Role debtor's attorney
- d. Role of 13 trustees
- e. Role of bankruptcy judge
- f. Plan
  - i. Who prepares
  - ii. Who approves
  - iii. What tests
    - 1. All disposable income
    - 2. Treatment of secured claims generally
      - a. "value" of property interest and *Rash*
      - b. "value as of the effective date of the plan" of plan distributions and *Till*

E.g., D owes S \$100,000. D has signed a note that provides for 10% interest and monthly payments of \$7,000 a month. At the time of the Chapter 13 filing, D still has to make payments to S for 15 more months. S has a security interest in D's dental equipment which is worth \$60,000.

3. Special rule for mortgages on debtor's principal residence
  - a. Can't modify
  - b. Strip off of certain second mortgages
  - c. Cure default
4. Special rule for some car loans
  - a. 910 days
  - b. Personal use of debtor
  - c. No cram down
  - d. Other changes

E.g., D buys a car 1 year before 13 bankruptcy. At the of the commencement of the bankruptcy case, D still owes \$30,000 to S who has a security interest in the car. The car is only worth \$20,000.

g. Discharge

## **PART FOUR: CHAPTER 11**

### VII. Chapter 11 Cases

a. Overview of WHAT CONGRESS INTENDED happen in  
11

b. Who can be a Chapter 11 debtor?

i. Businesses

ii. Individuals (much like Chapter 13)

c. Roles of Debtor's attorney

i. Operational issues such as financing agreement

ii. Plan negotiation and preparation

d. Roles of Debtor in Possession (DIP) or Chapter 11  
trustee

i. Business operation

ii. Plan negotiation and preparation

e. Roles of Unsecured Creditors Committee

f. Basic structural differences between Chapter 11 and 13

- i. Business operations issues
- ii. Creditor acceptance process
- iii. Discharge
  - 1. time of 11 discharge generally – confirmation
  - 2. time of 11 discharge if individual debtor – completion

g. Possibly exam important business operations issues

- i. Paying critical vendors and section 105
- ii. Obtaining postpetition financing [DIP loan] and section 364
  - 1. Cross collateralization
  - 2. Rollup

h. Possibly exam important plan process issues

- i. Exclusivity, 1121
  - 1. 120 days and 1121(b)
  - 2. Deadlines in DIP loan

- ii. Disclosure statement
- iii. Creditor voting (acceptance) process
  - 1. By “class”
  - 2. By those voting
    - a. More than ½ in number
    - b. At least two thirds in amount
- iv. Classification of claims
  - 1. Inclusion in a class - “substantially similar to the other claims”, 1122
  - 2. Exclusion – “substantially similar” in separate classes and gerrymandering
- v. Court approval (confirmation) standards
  - 1. Best interest – at least as much as 7
  - 2. Feasible – no further bankruptcies
  - 3. Payment of all priority claims
  - 4. All assenting impaired (altered) classes
  - 5. OR at least one assenting impaired class and [1129(b) a/k/a as cramdown]

- a. Not discriminate unfairly against dissenting class
  - b. “fair and equitable’. a/k/a as absolute priority rule
- i. Section 363 sales of all or substantially all of the assets
  - 1. Process
    - a. Hearing
    - b. Possible over bid protection for “stalking horse”
    - c. Credit bidding by secured creditors
  - 2. Possible exam problems
    - a. “free and clear” and section 363(f)
    - b. After the sale
      - i. Braniff
      - ii. 11 plan?
      - iii. Conversion to 7?
      - iv. Dismissal
  - 3. In sum,

- a. Possibly preserves going concern value
- b. Avoids costs and delays of plan process
- c. Connections between deadlines in DIP loans and 363 sales

## **PART FIVE: LEASES (AND EXECUTORY CONTRACTS)**

VIII. Effect of Bankruptcy on Leases (And executory contracts such as franchise agreements)

E.g., L leases a building to D Inc. for \$10,000 a month until December 2025. D Inc files for bankruptcy in January 2021.

a. Debtor's section 365(a) "options"

1. rejection (breach)

a. L has a "prepetition" unsecured claim

b. D Inc. must give up building

2. assumption (keep)

a. L has administrative expense priority claim

b.D Inc. keeps building and must cure defaults and continue to make lease payments without change

3. assignment (sell) to T

a. L has no claim against D Inc

b. L can enforce lease terms against assignee T

c. D Inc. keeps proceeds from lease assignments

b Role of the court, 365(a)

c. Time for deciding, 365(d)

1. non-residential real property, 365(d)(4)

- 120

- possible court ordered 90 days extension

2. residential or personal property leases and 7,

365(d)(1)

- 60

- possible court extension

3. residential or personal property leases in 11 and

13, 365(d)(2) - plan

c. Requirements for assumption/assignment

1, If no default and assumption



2. if assignment or default and assumption
  - a. cure defaults
  - b. adequate assurance of future performance
- c. Limitations on assumption/assignment
  1. contract provisions ineffective
    - a. bankruptcy termination clause, 365(e)
    - b. prohibitions on assignments
  2. common law or statutory prohibition on **assignment** effective as to both assignments and **assumptions**, 365©

E.g., D Co. licenses technology from X, Inc. Under patent law, D Co cannot assign that license. D Co. files for bankruptcy and wants to assume that license.

- d. Limitations on effect of rejection
  1. rejection by debtor/landlord, 365(h)
  2. rejection by debtor/"intellectual property" licensor, 365(n)

## **PART SIX: PREFERENCES**

IX. Effect of Bankruptcy on Prebankruptcy Payments to Creditors - Preferences

- a. Remember policy of equality of distributions
- b. Avoidance of prebankruptcy transfers under 550
- c. Elements of preference, 365(b)

i. Transfer of property of the debtor AND

1. Transfer

a. Payment

b. Lien

2. Property of the debtor

a. E.g., Momma pays some of Bubba's debts. Bubba files for bankruptcy

b. Earmarking

M gave 10,000 to D to use to pay C. D pays C. D then files for bankruptcy

ii. Five numbered elements in (b)

- 1. To and for the benefit of a creditor E.g., D owes C. G guaranteed D's debt to C. D pays C.

2. Antecedent debt
3. While debtor was insolvent
  - a. Assets (other than exempt assets)/liabilities
  - b. Rebuttable presumption that D insolvent for 90 days before bankruptcy
4. Within 90 days of bankruptcy or 1 year of bankruptcy if transferee is an “insider”
5. “Get more”, i.e., preferential effect
  - a. If creditor is fully secured, . . .
  - b. If creditor is unsecured

D owes C \$100,000. D pays C \$50,000, D files for 7 bankruptcy. At end of D’s 7 bankruptcy, holders of unsecured claims get 50 cents on dollar. Preferential effect.

- c. If creditor is partly secured

D owes C \$100,000. C has security interest in collateral worth \$40,000. Before bankruptcy, D pays C \$30,000.

- d. “”Ordinary course”, 547©(2)

- i. Ordinariness of debt
- ii. Ordinariness of payment method and time

E.g., D pays last month's cell phone bill. D Co pays landscaping service for last month's work.

- e. "After such transfer" exception

E.g., 2/2, D pays creditor C \$20,000; 3/3 C makes \$9,000 unsecured loan to D; 4/4 bankruptcy

- f. Indirect preference

E.g., D owes both F and S \$100,000. F has a first mortgage on Redacre; S has a second mortgage on Redacre. Redacre is worth \$101,000. D pays F \$99,000. A month later, D files for bankruptcy.

## **PART SEVEN: FRAUDULENT TRANSACTIONS**

- X. Pre-bankruptcy Transfers to Others
  - a. Debts/transfers with actual intent to defraud [badges of fraud] OR
  - b. Constructive fraud

- i. Less than reasonable equivalent value TO THE DEBTOR/TRANSFEROR

E.g., C makes loan to S Co. D Co guarantees S Co's payment and grants C a mortgage on Redacre as collateral.

- ii. Insolvent

- c. Comparison of preference law and fraudulent conveyance law

- i. Preference law unique to bankruptcy; all states have fraudulent conveyance laws which are a part of bankruptcy law

- ii. Nature of transferee

- iii. Time period

1. 547 -90/1 year
2. 548/544 – 2 years/?

- iv. Presumption of insolvency

1. 547 - 90 days
2. 548 and 544 – no presumption

## PART EIGHT: LOOSE ENDS

### XI. Loose ends

#### a. Involuntary bankruptcy, section 303

i. 3 petitioning creditors

ii. Generally not paying debts

#### b. “Strong arm” clause, section 544

i. Unrecorded mortgages

ii. Unperfected security interests

#### c. “Pre-packs”

#### d. APPROACH AN EXAM FACT PATTERN

i. TIME

##### 1. BEFORE BANKRUPTCY

a. EFFECT OF BANKRUPTCY ON PRE-  
BANKRUPTCY TRANSACTION

E.g., 547? 548?

b. EFFECT OF PRE-BANKRUPTCY ACTION  
ON BANKRUPTCY

E.g., 523 exception, 727 objection

##### 2. AFTER BANKRUPTCY FILING

E.g., 362 stay, 364 dip loan

### 3. AFTER CLOSE OF BANKRUPTCY CASE

E.g., 524 discharge

#### ii. PEOPLE

1. DEBTOR?

2. CREDITOR

a. SECURED

b. UNSECURED

c. PRIORITY

#### iii. OTHER