

Bankruptcy Glossary

Bankruptcy law is primarily federal law and varies little from state to state. The United States Constitution grants to Congress the power to establish uniform bankruptcy laws throughout the United States, which ensures uniformity in how bankruptcy proceedings are conducted, encourages interstate commerce, and promotes national economic security. The individual states do, however, retain jurisdiction over certain debtor-creditor issues that are not addressed by or do not conflict with federal bankruptcy law, such as which property remains exempt from creditors' claims.

Bankruptcy law provides two basic forms of relief: (1) liquidation and (2) rehabilitation, also known as reorganization.

- **Chapter 7 Liquidation.** Most bankruptcies filed in the United States involve liquidation, which is governed by Chapter 7 of the Bankruptcy Code. In a Chapter 7 liquidation case, a bankruptcy trustee collects the debtor's nonexempt property and converts it into cash. The trustee distributes the resulting fund among the creditors in a particular order of priority described in the Code. Not all creditors will receive the full amount owed through this process, and some may receive nothing. When liquidation and distribution are complete, the bankruptcy court may discharge any remaining debts of an individual debtor. If the debtor is a corporation, it ceases to exist after liquidation and distribution, and there is therefore no real reason for further discharge because the creditors cannot seek payment from an entity that no longer exists.
- **Chapter 11 or Chapter 13 Rehabilitation.** In a rehabilitation or reorganization, the option courts often prefer, creditors may be provided with a better opportunity to recoup what they are owed. Chapter 11 or Chapter 13 of the Bankruptcy Code governs this type of bankruptcy. Chapter 11 usually applies to individual debtors with excessive or complex debts, or to large commercial entities like corporations. Chapter 13 usually applies to individual consumers with smaller debts. (Farmers and municipalities may seek reorganization through the Code's special chapters, Chapters 12 and 9, respectively.) Reorganization provides a greater opportunity to retain assets if the debtor agrees to pay off debts according to a plan approved by the bankruptcy court. If the debtor fails to do so, however, the court may order liquidation.

Means Test. Debtors must meet a means test to determine if they are financially eligible for straight Chapter 7 liquidation. In brief, if a debtor can repay out of his adjusted current monthly income \$1000 each month to unsecured creditors, over a span of 60 months, he may not avail himself of Chapter 7 and must go into Chapter 13.

Voluntary Bankruptcy. In most instances, the bankruptcy case is filed by the debtor, which is considered a voluntary bankruptcy. Once the debtor files the bankruptcy petition, he or she is immediately entitled to relief from creditors through the bankruptcy procedure known as the automatic stay. **The automatic stay** freezes all debt-collection activity and forces the creditors to allow the bankruptcy proceeding to determine how payment will be made.

Involuntary Bankruptcy. Under Chapters 7 and 11, creditors, too, have the option of filing for relief against the debtor, which is known as an involuntary bankruptcy. Involuntary bankruptcies are allowed only when there are a minimum number of creditors and a minimum amount of debt. The debtor has the right to file a response, after which the court determines whether the creditors are entitled to relief. If the court dismisses the involuntary bankruptcy filing, finding that it has no merit, the creditors may have to pay the debtor's attorneys' fees, damages for any losses the debtor experienced because of the bankruptcy, and even punitive damages to punish the creditors for the frivolous or abusive filing of a petition.

Lawyers specializing in bankruptcy law can help both debtors and creditors overcome obstacles to the repayment of debt. Their expertise often extends beyond bankruptcy to include debt repayment and collection options that can circumvent the need for a bankruptcy filing. The following are just some of the areas in which bankruptcy lawyers can assist their clients.

Collections and repossession are remedies sought by creditors against debtors who have defaulted on their obligations. Collections include any technique to get the debtor to make up the remaining debt, including use of a collection agency or the courts. Creditors may also have outstanding debts legally recognized, and then enforced against a debtor's property involuntarily with garnishments, liens, or levies. Repossession of collateral is another technique used when property is pledged to secure a debt.

Commercial bankruptcy is a remedy available to businesses that are unable to pay their debts. Options include liquidation, in which many of the business's assets are sold and the proceeds are divided among the creditors, and reorganization or restructuring, in which the business continues to operate according to a plan that allows for at least partial payment to creditors.

Consumer bankruptcy is a method through which individuals may be able to get out from under insurmountable debt and make a fresh start, albeit with a negative impact on their credit ratings. As in commercial bankruptcy, there are two options: liquidate assets to pay off creditors, or file a wage-earner plan that allows the debtor to retain more assets while working to pay off his or her debts.

Creditors' rights include a full range of options available to creditors to collect unpaid debts. These rights include collection actions, repossession, foreclosure, garnishment, replevin, attachment, obtaining a court judgment, liens, and forcing the debtor into involuntary bankruptcy.

Discharge is the bankruptcy term for wiping out many of the debtor's remaining debts at the conclusion of the bankruptcy proceeding. A discharge is available to only certain debtors, however, and only certain debts are dischargeable.

Foreclosures are the actions taken when a mortgagor fails to make the required mortgage payments on time and the lender, or mortgagee, forces the sale of the property — often the debtor's home — to pay off the debt. Foreclosures can be either judicial, which requires court involvement, or pursuant to a clause in the mortgage that allows for such sales.

Garnishment is a creditor's remedy aimed not directly at the debtor but rather at a third party who owes money to the debtor or holds some of the debtor's property. The garnishment process notifies the third party that the creditor intends to apply the third party's property to satisfy the debtor's debt. Typical garnishees, as the third parties are called, include the debtor's employer and the bank in which the debtor has his or her accounts.

Reorganization and restructuring are methods by which a bankrupt business may reorganize itself in order to keep operating and pay off creditors at least part of what it owes. This commercial bankruptcy option has many advantages over liquidation, which requires selling off many assets and after which the business ceases to exist.

Workouts are non-bankruptcy agreements between debtors and creditors in which the creditors agree to take less money than the full amount owed or accept payments over a longer period of time than originally anticipated. Workouts have the advantages of being voluntary, less complicated, and less negatively perceived than bankruptcy.

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