

A GUIDE TO FILING FOR REORGANIZATION UNDER

CHAPTER 11 OF THE BANKRUPTCY CODE

Michael R. Totaro
Totaro & Shanahan
P.O. Box 789
Pacific Palisades, CA 90272
310 573 0276 (v)
310 496 1260 (f)
Mtotaro@aol.com

GUIDE TO OBTAINING REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE

I. Introduction:

Any type of legal action takes planning. The decision to file for bankruptcy protection is no different. Through planning, personal property, cash and even real property may be saved. As with any legal proceeding you will have to make a decision whether or not to represent yourself, hire a paralegal or hire an attorney. The bankruptcy field is no different. Prior to the law being changed in 2005 we did refer people to paralegals when then could not afford our fee. However the changes in the law have made the procedure so complex that we can no longer suggest that you represent yourself or use a paralegal. There are too many areas that need legal advice to be able to navigate your way through the process and obtain a discharge.

II. Types of Bankruptcies:

There are three principle types of bankruptcies, Chapters 7, 11 and 13. This article is only concerned with a Chapter 11 filing, and refers to the terms liquidation and “fresh start.” Liquidation is simple. It means all the assets of the person owing the money (called the debtor) are collected by a neutral person (called a trustee), sold and the money given (disbursed) to the people to whom money is owed (creditors). This usually only applies to a Chapter 7 proceeding but can apply to a Chapter 11 if a trustee is appointed. However, there are many exceptions to this rule (called exemptions) allowing you to keep most of your personal property and a large amount of cash. (Fed. B.C. § 101.) The policy behind a Chapter 11 filing is to reorganize an individual or business and give the debtor a “fresh start.” In many cases all the assets are exempt and there is limited distribution to the creditors.

A. The Parties Involved:

There is no trustee who handles your case in a Chapter 11. You are the trustee and are called the Debtor in Possession. This means you are the debtor and responsible for handling your estate and thus “in possession” of the property. It is your responsibility to act for the benefit of the creditors and your bankruptcy estate, not for yourself, since you take the place of the Chapter 7 or Chapter 13 trustee. All of your decisions must take into account the well being of the unsecured creditors as the secured creditors have collateral upon which to secure their claims.

You will also be involved with the United States Trustee (UST) who is charged with the duty of overseeing your case. You will meet with the UST twice at the beginning of your case and then submit Monthly Operating Reports (“MOR’s) to that office by the 5th of the month following the end of the prior month. Thus your report for January is due February 5th and late by February 15th. One late report is grounds for the appointment of a trustee or dismissal. If a trustee is appointed your estate will be liquidated (sold off) and the money disbursed to your creditors. The UST must receive an original signed by the debtor or joint debtors, i.e., husband and wife, and you must fax a copy to our office or email a scanned copy. The copy you send to our office cannot be over 2.5 megabytes in size since I have to upload it to the court. This report is based on a calendar month, not bank statements. You look at all of the income and expenses incurred during the prior month and look at the beginning and ending balances on those days. You do not balance the report to the bank statements but you must attach those statements redacting all account numbers except for the last four.

You may also have some contact with the bankruptcy court as some judges require your presence at status conferences. I will let you know which hearings you may have to attend.

B. The Pre-Confirmation Process:

The Chapter 11 process is long and detailed. During the process you will have certain timing deadlines that must be met or your case could get dismissed. These start

right at the beginning. We will work closely with you to get you started, but once into the process the responsibility is entirely yours.

1. Prior to Filing:

Upon retaining our firm you will be given a “7 day packet.” This is a packet of documents that you must complete and file with the United States Trustee 7 days after filing the bankruptcy petition. Our paralegal will assist you with this package but the information must come from you. Included in that packet is a Real Property Questionnaire that must be filled out for each property. There is also a sample MOR for you to review and a list of items you will need to obtain.

Also you need to obtain appraisals on all the properties and obtain copies of any lease agreements you have with tenants.

2. The First Day:

The first day after we file is intense. You must do the following:

a. Obtain a Tax ID number from the IRS for a Chapter 11 case. You may do this on line at www.irs.gov or call them 800 829 1040.

b. Go to the bankruptcy court and obtain a certified copy of the petition we filed. The courts are located in Los Angeles, Woodland Hills, Santa Barbara, Riverside and Santa Ana depending on where you live. The valley goes to Woodland Hills, Ventura County to Santa Barbara, the rest of LA County to downtown, Orange County to Santa Ana and Riverside and San Bernardino Counties to Riverside. Although you have many pages to your petition, the certified copy is only of the first three pages. We will tell you what court to go to.

c. You must then take the certified copy and record it in every county where you own property. Therefore if you own property in two counties you must obtain two certified copies. If you own property in three counties, you must obtain three copies and so forth. You must get a receipt for the recordings and give that receipt to my paralegal. This includes out of state counties.

d. Next you must close all existing bank accounts and obtain a -0- balance statement from each account to give to my paralegal. All accounts must be closed, no exceptions. There may be some overlap because you may have automatic deductions or payroll deposits coming from or into your accounts but you must cut those off as soon as possible and transfer them to the DIP account.(See e. below) Before you close the account make sure you obtain 4 months of bank statements. We will need these to give to the UST.

e. Next you must open a Debtor in Possession account, called a DIP account. This is sometimes hard to do as the not all of the banks know what this is. You can come to Pacific Palisades to the Wells Fargo office there or you can go to any Chase Bank but have them call Monica in Norco at 951 304 3478 if they don't know what you are talking about. Make sure you obtain an ATM card from that account as you must track all your expenses.

The account must state your name and address and also it must say Debtor in Possession account with your bankruptcy number on the checks. Obviously this will identify you as being in bankruptcy every time you write a check which is why the ATM is important. However, you cannot use your ATM for cash advances. If you take out cash you must account for everything you spend it on by obtaining a receipt. You can use this ATM card exactly as you use a credit card as long as there is money in the account. This means you can use it to rent a car, plane tickets etc.

If you own multiple properties you may consider having three DIP accounts: One for your personal expenses, one for mortgages and rents and one for security deposits. You would have to submit 3 MOR's each month but the security account would rarely change and the mortgage account would be just rents and payments. This is up to you. Some lenders may require a separate account for their properties. I will let you know if that happens.

You will also have to contact the carriers for your property insurance and add the United States Trustee's office handling your case as "an interested party". This applies to

real property, vehicles, boats etc. The UST will thus receive any notifications as to whether any policies have lapsed. It is your duty to assure all property is insured in order to protect the bankruptcy estate.

3. Days 2 through 7:

During this time you will have to complete the 7 day packet. It is your job to compile the information and send it to our paralegal who will prepare the documents to submit to the UST. She will be in contact with you and may have questions for you. She may not be familiar with the particulars of your case so please answer her questions as she will be compiling the documents you send her. The 7 day packet must be delivered to the UST by the 7th day after filing. You will get a copy for your use.

4. Court Appearances/Meetings:

In referring to court appearances I am referring to actual appearances in court and meetings with the UST and creditors.

Your first meeting will be with the UST and is called an Initial Debtor Interview (IDI). This is an informal meeting where we meet with a representative of the UST and tell them what we are doing and how. Some of the trustee's offices do not hold this meeting on our cases as they know what we are doing. Some hold the meeting in conjunction with the Meeting of Creditors and some hold a separate meeting.

At the meeting you will present a valid government issued photo ID such as a valid driver's license or passport and the original of your social security card. No photocopies are accepted. If you do not have these documents they will not interview you and your case will be dismissed.

The representative of the UST will question you and me as to what our plan is and how we propose to proceed. I will answer a lot of these questions but you will have to tell them why you are in bankruptcy and what led you there. An answer that the economy has gone down is not sufficient. Be specific. Laid off, decrease in hours or pay, loss of rents, etc. etc. The meeting is very informal, lasts about 20 minutes and you are not under oath. Also at this meeting the UST will explain the fee schedule for paying the UST fee for the

privilege of allowing you to file a bankruptcy. This fee is based on the disbursements out of your DIP account. If you are under \$15,000 in any quarter the fee is \$325.00 a quarter. If you are between \$15,000 and \$100,000 the fee is \$650.00 a quarter. Most people fall in this category. That fee is due by the 15th of the month following the end of the quarter. Thus the fee for the quarter ending March 31st is due by April 15th and so forth.

Your second meeting is called a section 341 meeting and is a Meeting of Creditors. Rarely if ever does a creditor appear. Usually only friends, relatives or jewelry stores show up to see why you are putting them in the bankruptcy. (You have no choice, all creditors must be listed.) This is a more formal hearing; you are placed under oath, and will be asked about the same questions you were asked at the IDI. If there was no IDI then this will be your first exposure to the process. Your responsibility is to answer directly and truthfully but don't elaborate unless asked to do so.

After the 341 hearing the next event is the status conference. Currently only a couple of judges require your attendance. I will let you know if you have one of them. In all likelihood you will not talk but will be available if the court has a question.

5. Post Petition Status Conference:

This will be in 3 to 5 years depending on your income and how much you have to pay back. You must make all of your secured payments on time, meaning the first of the month for mortgages and the due date for vehicles. You will not have to repay any arrearage on your mortgage or pay the unsecured creditors until after a plan is approved. There are occasions where we will need to work with you and obtain information and/or documents of your signature on documents submitted to the court. If we request information from you it is important that you respond promptly. There are time constraints which are very important in a chapter 11 so a prompt response is critical.

C. Confirmation:

The purpose of the entire process is to get confirmation of a plan that is feasible to you, and has the approval of the creditors. All of your debt is divided into classes. Each secured loan is its own class and all of the unsecured debt is placed in one class which

includes credit cards, signature loans, student loans, unsecured second mortgages or HELOCS and the unsecured portion of the first mortgages on rental property.

To get approval we need the acceptance of one secured class and hopefully the unsecured class. To obtain approval of the unsecured class we will have to offer them a percentage of the total debt, usually 5% to 20% depending on your disposable income. As to the unsecured class of the entities **who vote** we must have 51% of the creditors **AND** 2/3 of the amount of debt vote in favor of the plan.

What stands in our way is something called the absolute priority rule (APR). Under this rule if the unsecured creditors do not vote for the plan the debtor cannot retain his or her interest in pre-petition property unless 100% of the unsecured debt is paid. Not all courts are following this rule and currently it is a hot topic around the United States. The courts across the country are split on whether this applies to individual debtors. In the Central District there is also a split with most courts holding the APR does not apply and at least two judges holding it does. Our office is appealing a negative ruling but that will take at least a year to resolve. In the meantime we have to take things as they come. If we have approval as stated above, the APR does not apply.

If for some reason the plan is not confirmed we have other options. We can resubmit a plan to pay more to the unsecured creditors, file an appeal if the reason for the lack of confirmation is the APR or we can discuss whether it is worth it for you to continue as planned. Those options may not arise so we will discuss them later.

D. Post-Confirmation:

After confirmation a number of important events take place:

First, you may close your DIP account. You no longer have to protect property of the estate because confirmation vests the property of the estate back to you.

Second, you begin making payments according to the plan on the first of the next month following plan confirmation. So if your plan was confirmed in April, you begin making payments May 1st and so forth. These may be made from a normal checking account that you can now open as long as you continue to track your income and

expenses. We will send you sample letters to make your payments to your secured and unsecured creditors and you will send them that letter with a copy of the plan and the court's order approving the plan.

Third, you no longer file monthly reports. Instead you file a one page quarterly report.

Fourth, after you have made payments for two consecutive months we will file a motion for a final decree, discharge and closure of your case. Once signed by the court you will no longer have to do any reports and you will no longer have to pay the trustee fee. If the case is closed mid quarter, you still owe the fee for that quarter.

Once the final decree and discharge are entered you are done. You just continue to make your payments until all payments have been made. **IF YOU STOP MAKING THE PAYMENTS, FOR ANY REASON, THE CREDITOR MAY MOVE TO REOPEN YOUR CASE TO HAVE IT DISMISSED AND YOU WILL BE RIGHT BACK TO SQUARE ONE SO MAKE SURE ALL PAYMENTS ARE MADE UNDER THE PLAN.**

E. Discharge:

The terms "discharge" and "non-dischargeable debts" have legal significance. A discharge is a court order that excuses the debtor from all debts listed in the bankruptcy petition, except those found to be non-dischargeable.

The Federal Bankruptcy Code lists specific items that cannot be discharged in a bankruptcy proceeding. In legal jargon these are non-dischargeable debts:

1. Certain Taxes, if due within the last three years.
2. Money, property, services or credit obtained by fraud including false financial statements. This also includes certain debts incurred in the 60-day period prior to the filing of the bankruptcy petition.
3. Money obtained by fraud, embezzlement or theft and debts incurred for an intentional or malicious injury to the person or property of another.
4. Alimony, maintenance and support, with very limited exceptions.

5. Government fines or penalties including criminal restitution.
6. Money obtained for educational benefits and student loans.
7. Liability for death or personal injury caused by drunk driving.
8. Debts that were or could have been listed in a previous bankruptcy case where the debtor did not receive a discharge.

F. Miscellaneous:

1. Exemptions:

You must list all of your assets in the bankruptcy, this means everything that you own. This does not mean that you will lose the property and in most cases a Chapter 11 is reorganization so you are entitled to retain most of your property although it may be advisable to surrender certain real property which is simply not profitable or likely to be profitable after a reorganization. Thus it is important to discuss your assets with your attorney.

The Bankruptcy Code provides for exemptions for certain property. (Fed. B.C. § 522(b).) If all of the property falls into the exemption then the case is called a no asset case and the creditors get nothing. Property falling into one of the exemptions may be kept by the debtor both during the proceeding and after the case is discharged. Property that may not be exempt may be converted to exempt property before any petition is filed. The value of the property is the value on the date of filing. (Fed. B.C. § 522(a)(2).) In the Chapter 11 context we use the exemptions to reduce the amount of money one has to pay to the unsecured creditors. If the property is exempt it is not counted in the property available to pay creditors. Thus if you had \$100,000 equity in a primary residence, if you did not exempt it, you would have to pay \$100,000 to the unsecured creditors. Whatever portion of the equity we are able to exempt means that portion is not available to be paid to the unsecured creditors.

California has chosen to opt out of the Federal Bankruptcy exemptions. (Cal. Code Civ. Proc. § 703.130.) This means the debtor may chose between two different sets of

exemptions under state law. (Cal. Code Civ. Proc. §; 703.140(b); 704.010 et seq.) Each of these sections are more liberal in favor of the debtor than the federal exemptions. Also there is a third section for those who want to avoid the court system and proceed under an Assignment for the Benefit of Creditors. (Cal. Code Civ. Proc. § 1801 et seq.)

2. Types of Creditors:

There are two types of creditors, secured and unsecured. A secured creditor is one that retains some rights as to the property of the debtor, such as a car lease, your mortgage company, etc. An unsecured creditor is someone with no lien or mortgage against the property. An example of this is medical bills, credit cards, personal loans, etc.

Concerning a secured creditor, the debtor has three choices:

1. Reaffirm: This is an agreement (a reaffirmation) between the creditor and the debtor that the debtor will continue to make payments on the debt. The creditor cannot repossess the property as long as payments are made. The court must approve any agreement between the creditor and debtor for it to be binding on the creditor. While a debtor is free to repay any debt the debtor chooses, without any obligation to another creditor, this defeats the purpose of a “fresh start.”

2. Redeem: The debtor has the option of purchasing the property, usually for a one-time cash payment.

3. Release: The debtor may simply give the property back and the debt will be discharged. If the value of the property is less than what is owed, the additional sum is still discharged.

Concerning utility companies, if you furnish the company with a deposit or other security within 20 days of filing the petition, to make sure future services are covered, they cannot discriminate against you. (Fed. B.C. § 366(b).) However, the better practice would be to pay the bills before filing so they are not considered a creditor.

You must list all of your creditors whether secured or unsecured. They will be provided with notice and a proof of claim form so they may submit a claim in your

chapter 11 bankruptcy. It is very important that you advise your attorney of all your all creditors so they may be listed and an accurate assessment of your financial picture obtained. You can not pick and choose which creditors to list and cannot give preferential treatment to any unsecured creditor, particularly family and friends to whom you owe money.

Finally, after discharge a creditor cannot attempt to collect any pre-petition debt that has been discharged. The remedy for any attempt is a contempt order from the court. Any attempts at collection should be reported to your attorney who will provide the creditor with a copy of the discharge. If the creditor continues to try to collect the debt, an action may be brought in the bankruptcy court for the violation.¹

3. Who Can File:

Anyone who resides in, does business in, or has property in the United States may file under a Chapter 11 proceeding except the following:

1. Any person involved in a previous bankruptcy case that was dismissed within the last 180 days and is under a court order prohibiting the filing of another case;
2. Any person who has been granted a discharge under Chapter 7 or 13 within the last 4 years. (Fed. B.C. § 109; 28 U.S.C. § 1409.) There are some exceptions to this.

4. When Should You File A Chapter 11:

A determination of whether or not you should file bankruptcy depends on both a common sense and legal analysis of all of the following items. This is perhaps the key reason why you should consult with an attorney instead of a paralegal. Factors an attorney will look at are:

1. The type of debt you have, dischargeable v. non-dischargeable.
2. The extent of your debt and whether there are other alternatives.
3. Your income and whether you have the ability to repay part or all of your debt over time.

¹ Discharges are only effective in favor of the debtor, not any cosigner on a loan or account. The co-signer would still be responsible unless that person is the spouse who is also named as a party in the bankruptcy.

4. What exemptions may be claimed.
5. Have all debts been incurred and have nonexempt assets been converted to exempt assets.
6. Has all non-exempt property been received.
7. An analysis of all trusts, life insurance policies, divorces within 180 days, pending foreclosures, and cash advances.
8. Do you have over \$360,000 of unsecured debt or over \$1,080,000 of secured debt that makes you ineligible to file a Chapter 13.
9. Are you running a business. You cannot file a Chapter 7 if you are running a business.

5. Credit Counseling/Debt Education:

One of the new requirements to filing is that you must undergo two sessions of credit counseling. The first session is called Credit Counseling and the second Debt Education. These sessions are accomplished on the internet through private companies. There seems to be a range of prices with the average being \$25.00 for the Credit Counseling and \$11.00 for the Debt Education. You must complete the Credit Counseling no more than 180 days before filing and complete the Debt Education within two weeks of filing. If you fail to complete either session you will not receive a discharge.

6. What About Your Credit After Filing:

Any bankruptcy filing remains on your credit for report for 10 years. While this may seem burdensome, it is a trade off for being able to discharge all your debts, protect your remaining assets and for saving your home. In short, it's a trade off for getting a fresh start.

You are not precluded from purchasing a home after a bankruptcy however you can expect the following:

1. Some lenders only working with "A" or "B" credit will deny you a loan.
2. Some may require a higher down payment.
3. Some will charge you additional points

4. Some will charge you a higher interest rate and higher points.

As to credit cards, again the rules are similar. There are some credit card companies that will send you a credit card almost immediately when you send them proof of your discharge. However, the fees will be exorbitant and the credit limits very low, at least for the first year.

As to vehicles, this is something to talk to your attorney prior to filing the bankruptcy. Your attorney will advise you how to obtain a vehicle that will remain in good condition until you rebuild your credit.

There is always some embarrassment associated with filing for bankruptcy. There should not be. This is a legitimate legal tool to safeguard your assets and your future. Do not let any creditor give you a different impression.

7. Public Disclosure:

The filing of the bankruptcy petition causes the case to become a public record. Credit agencies are notified of the filing, as are your creditors. While business filings may be published, usually individual filings are not, unless they involve some person who is famous before the filing.

Employers are not notified of the filing and they cannot fire you because you filed for bankruptcy protection. The filing of the petition is not a criminal proceeding. Employers and governmental agencies cannot discriminate against any person who files for bankruptcy protection. This includes the fact you cannot be denied any kind of a license because of the filing.

The MOR's you file are available on line for the world to see. Therefore redact any account numbers or personal information.

The following are some dos and don'ts that will make the process easier for all of us. Nothing here is random. Each item is meant to speed up the process and avoid problems that we have had in the past.