

to the creditors. The Chapter 7 case is over when any and all funds have been distributed by the trustee and when the bankruptcy court enters an order officially closing the case. If the trustee determines that the case is a no-asset case because there is no money for the trustee to distribute to creditors, the case may be closed shortly after the debtor is granted a discharge.

If the trustee is able to collect money to pay creditors, the creditors will be notified and instructed by the clerk of court to file a "proof of claim," which is an official form used by creditors to present their claims to the court for payment. Generally, creditors must file a proof of claim by the deadline set by the court in order to participate in any distribution of funds from the trustee.

### **CHAPTER 13: "WAGE EARNERS" BANKRUPTCY**

There are several reasons why a debtor may choose Chapter 13 bankruptcy over Chapter 7. Chapter 13 can allow a debtor to stop a foreclosure or repossession, allowing the debtor catch up payments over the course of 3 to 5 years. Chapter 13 also allows a debtor with non-exempt equity to retain the property by paying the value of the property over the Chapter 13 plan. In some circumstances, Chapter 13 can allow the debtor to eliminate a second mortgage or reduce the amount owed on a vehicle. Chapter 13 can also allow a debtor to address certain nondischargeable obligations, such as taxes and child support arrears, by paying these obligations over time in an affordable monthly payment. Student loans can also be effectively deferred while in bankruptcy. In some circumstances, the debtor may be able to structure an income based repayment agreement with student loan creditors even while in Chapter 13 bankruptcy. Finally, chapter 13 can also be utilized by higher income debtors who would otherwise be ineligible for Chapter 7 bankruptcy.

In Chapter 13, the debtor proposes a "plan" of repayment under which they offer to pay a fixed monthly payment to a Chapter 13 trustee for a period of time, typically from 36 to 60 months (3 to 5 years), beginning when the case is filed. The trustee distributes these funds to the creditors until the debtor has made all monthly payments required under the plan. In many cases, the debtor is not required to pay anything to unsecured creditors, with the plan payments devoted solely to the payment of secured or priority claims, such as taxes and child support. If the debtor has high disposable income or substantial non-exempt assets, the debtor may be required to pay some or all unsecured debts in full. After the debtor completes all payments required under the plan, all general unsecured debts are "discharged" or eliminated.

Once the petition is filed, the clerk of court schedules a meeting of creditors, notifies the creditors listed

on the debtor's schedules that the debtor has filed for Chapter 13 bankruptcy protection, and instructs creditors to file a "proof of claim," which is an official form the court mails to all scheduled creditors. Creditors must be mailed a copy of the plan and will be given an opportunity to object to the plan on the grounds that it does not meet certain legal guidelines. Creditors must file a proof of claim by the deadline set by the court (approximately three months after the first meeting of creditors) in order to participate in any distribution of funds from the trustee. At the creditor's meeting, the trustee reviews the petition, schedules, statement of financial affairs, and plan, and explains the plan to the creditors attending. The creditors may inquire about the location of collateral or how their claim is to be paid within the Chapter 13 plan. If the plan satisfies certain legal guidelines, the trustee will request that the plan be reviewed and approved, or "confirmed," by the judge. In order for a plan to be confirmed, the debtor must be current on all post-petition child support and alimony payments and must have filed all required tax returns, and the plan must satisfy other legal requirements. If the plan is confirmed, the trustee will disburse funds each month to the creditors as set out in the plan.

If the debtor fails to make monthly payments to the Chapter 13 trustee as required by the plan, the bankruptcy case may be dismissed by the court upon the request of the trustee or any creditor. If the debtor fails to make monthly payments to a secured creditor as required by the plan, that creditor may request that the stay be lifted to allow it to repossess its collateral. While the Chapter 13 plan is pending, the debtor may also convert the case to a Chapter 7 bankruptcy case or may voluntarily dismiss the case.

When the Chapter 13 plan is successfully completed, the debtor's personal liability for debts listed on the original schedules are discharged. As in Chapter 7 bankruptcy, certain debts including some long-term debts, alimony, child support, and most student loans are not dischargeable in Chapter 13. The debtor also cannot receive a discharge under Chapter 13 if the debtor received a discharge in a prior Chapter 7, 11 or 12 case filed within four years of the present case or if the debtor received a discharge in a Chapter 13 case filed within two years of the present case.

### **CHAPTERS 11 AND 12**

Business bankruptcies and reorganizations under Chapter 11, and farmer or fisherman reorganizations under Chapter 12, are beyond the scope of this pamphlet. Please consult with an attorney should you have questions regarding corporate and farmer or fisherman reorganizations.

# THIS IS THE LAW

## FILING FOR BANKRUPTCY

This pamphlet was prepared as a public service by the Communications Committee and is not intended to be a comprehensive statement of the law. North Carolina laws change frequently and could affect the information in this pamphlet. If you have specific questions with regard to any matters contained in this pamphlet, you are encouraged to consult an attorney. If you need an attorney, please contact the North Carolina Lawyer Referral Service, a nonprofit public service project of the North Carolina Bar Association, via phone (1.800.662.7660) or online ([www.ncfindalawyer.org](http://www.ncfindalawyer.org)).

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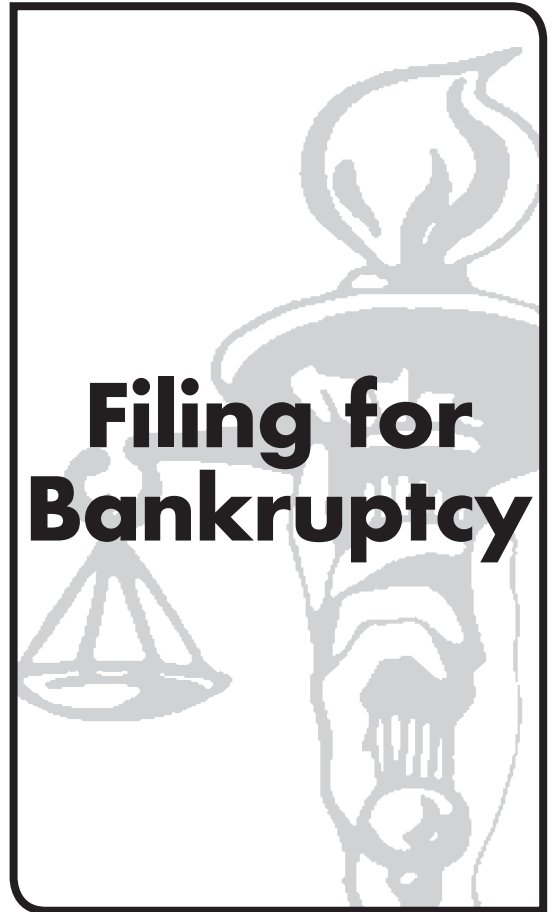
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## OVERVIEW OF BANKRUPTCY

The Bankruptcy laws are federal laws, and the bankruptcy courts are part of our federal court system. When individuals cannot pay their creditors, they may seek a “fresh start” through bankruptcy to allow for a restructuring and/or discharge of their pre-bankruptcy debts. In all bankruptcy cases, the person filing the bankruptcy petition is called the “debtor,” and a person to whom the debtor owes money is called a “creditor.”

While there are several types of bankruptcy proceedings, the most common forms of bankruptcy proceedings for consumers (i.e., individuals) are Chapter 7 and Chapter 13. A Chapter 7 involves the discharge (i.e., the elimination) of most forms of unsecured debt. Unsecured debts are those where the lender does not have a lien on assets owned by the debtor (e.g., credit cards, medical bills, signature loans). Some unsecured debts survive the Chapter 7 filing (e.g., most student loans, some types of taxes, child support, alimony, other domestic obligations). With secured debts like debts secured by homes or vehicles, as long as the debtor is current, the debtor can typically retain the item as long as the debtor is current on payments and continues to pay the monthly payment. The debtor may also elect to surrender the collateral and eliminate the debt.

With Chapter 7, the debtor is permitted to retain assets that are “exempt” under North Carolina and/or federal law. For most debtors, this means that the debtor is able to retain all assets, including real property and vehicles. If the debtor owns assets that are non-exempt, the assets may be sold by the court representative (called a “trustee”), with proceeds distributed to creditors pro rata. In some cases, the debtor may own property worth more than the available state or federal exemption. If the debtor wishes to protect this property from Trustee sale, the Debtor may instead opt to file a Chapter 13 bankruptcy to pay the value of the equity over time.

Chapter 13 bankruptcy involves a restructuring of an individual’s debts through payments under a Chapter 13 plan. Under the typical Chapter 13, a debtor makes monthly payments of the debtor’s disposable income (i.e. income above reasonable monthly expenses) to creditors through a Chapter 13 plan approved by the bankruptcy court and administered by a Chapter 13 trustee. The payments under a Chapter 13 usually last from three to five years and upon completion of the Chapter 13 plan, the debtor can receive a discharge of all of its pre-bankruptcy liabilities addressed in the plan.

The most common reasons that a person seeks relief under Chapter 13 include (1) stopping foreclosure and securing up to five (5) years to catch up mortgage payments; (2) the elimination of some second (or more junior) mortgages; (3) the restructuring of vehicle payments in order to avoid a repossession and/or to secure

a lower vehicle payment; (4) the restructuring of some tax liabilities; and (5) the payment of the non-exempt property value (see Chapter 7 discussion) over time in order to retain assets.

In addition to Chapter 7 and Chapter 13, individuals can also file for Chapter 12 or Chapter 11. Chapter 12 reorganization is similar to Chapter 13 but is restricted to family farmers. Chapter 11 is a much more complicated reorganization in which the debtor (usually a corporation or LLC) continues to operate under the supervision of the Bankruptcy Court. Chapter 11 may also be helpful to individuals where the amount of the debt is extremely large such that the individual would not qualify to file Chapter 13, which has limits on the amount of debt a debtor can have. Because Chapter 11 and 12 bankruptcy cases are so complex, and because consumers rarely use them, they will not be discussed in this pamphlet. Please consult with an attorney should you have questions regarding corporate and farm reorganizations.

This pamphlet only offers a brief summary related to filing for bankruptcy protection. If you are considering bankruptcy as an option, we strongly recommend that you consult with a bankruptcy attorney to discuss how bankruptcy operates and how it would affect you.

## FILING FOR BANKRUPTCY

Bankruptcy cases begin when a “petition” is filed with the bankruptcy court. The petition has several parts which disclose all of the debtor’s assets, liabilities, income and expenses. The petition, schedules and statement of financial affairs are court-authorized forms which must be completed, signed under penalty of perjury, and filed with the bankruptcy court, along with the payment of the filing fee. All debts owed by a debtor must be listed on the schedules, and all property, no matter where located, must be revealed. There is no such thing as leaving a debt or property outside of bankruptcy and it is impermissible to attempt to do so. However, debtors may be able to keep a certain amount of their property after filing for bankruptcy, even in a Chapter 7 case, because a certain amount of their property is protected as “exempt” and is not subject to liquidation by a trustee in bankruptcy.

One of the most important aspects of bankruptcy is the “automatic stay.” Upon a bankruptcy filing under either Chapter 7 or Chapter 13, almost all pre-bankruptcy creditors of the debtor are automatically “stayed” meaning that creditors are not allowed to collect pre-bankruptcy debts or recover collateral from the debtor unless they have the permission of the bankruptcy court. The most common exceptions to this rule are that some domestic court proceedings and some criminal proceedings are allowed to continue without pause.

Although most individuals qualify for Chapter 7 relief, there are times where a person’s income, less reasonable expenses, leaves significant disposable income (i.e., extra income not needed for reasonable expenses). If the amount of disposable income is high enough, then the person may be required to repay a portion of the person’s unsecured debts through a chapter 13. This analysis is determined, in part, using an income analysis called the “Means Test.”

Before an individual files the bankruptcy petition they must also obtain a special bankruptcy briefing from an approved nonprofit budget and credit counseling agency. You do not need to obtain the credit counseling before seeing an attorney, and your attorney will be able to provide you with a list of easily accessible credit counseling courses in advance of your filing. An individual debtor also must complete an approved instructional course concerning personal financial management after the petition is filed. After the case is filed, if required, the debtor must attend hearings, cooperate with the trustee in administering the estate, and provide copies of the debtor’s tax returns and other financial documentation to the trustee and creditors upon request.

A creditor in a bankruptcy case is designated a “secured creditor” if the debtor has pledged property as collateral for a debt. For example, if the debtor purchases furniture, a vehicle or a home through monthly installments, the item being purchased may be security or collateral for the installments yet to be paid. The lien held by the secured creditor on the property usually remains intact throughout the proceeding and continues even after the debtor receives a discharge and the case is closed. If a valid secured claim is not paid, either through a Chapter 13 plan or directly by a debtor, the secured creditor may bring an action to repossess the collateral once the case is closed, or during the case if relief from the automatic stay is granted by the court. In certain limited situations, the lien of a secured creditor may be avoided in its entirety by the debtor.

An “unsecured creditor” is a creditor whose claim is not secured by any property. Examples include credit card accounts, medical bills, and cash advance loans.

A federal bankruptcy judge presides over the bankruptcy case, and resolves any disputed issues which may arise while the case is pending. For example, the judge may determine whether a claim is secured or unsecured, whether a creditor is entitled to repossess property pledged as collateral for a debt which is not being paid by the debtor, and whether or not the debtor is entitled to a discharge.

When someone files for bankruptcy, the clerk of the Bankruptcy Court notifies all of the creditors listed in the debtor’s petition of the filing of the case, and schedules a meeting of creditors. The meeting of credi-

tors is conducted by the trustee and is usually held at a nearby federal courthouse. At this meeting the trustee reviews the petition, schedules and statement of financial affairs, and may ask questions about the debtor’s assets, liabilities and financial affairs. Creditors are also allowed to ask the debtor questions. The debtor is required to attend and testify at this meeting.

While both Chapter 7 and Chapter 13 bankruptcies have these things in common, there are several important differences between these two types of bankruptcy most suited for individuals.

## CHAPTER 7: STRAIGHT BANKRUPTCY

In a Chapter 7, or “straight” bankruptcy, the debtor is unable to repay their debts and seeks an immediate discharge of their debts in exchange for the surrender of any non-exempt property. As discussed above, most debtors retain all property as exempt. Once the bankruptcy petition is filed, the clerk of court schedules the meeting of creditors and a trustee is appointed by the court to administer the case. Typically, unsecured debts remaining unpaid are canceled or “discharged” at or before the conclusion of the Chapter 7 case. However, exceptions to the discharge include money owed for certain taxes, most student loans, fraudulent debts, child support, alimony, obligations arising out of the equitable distribution of marital property, and governmental fines. In most cases, the debtor’s bankruptcy discharge is granted within several months after the filing of the case. The debtor cannot receive a discharge in Chapter 7 if the debtor has received a Chapter 7 or Chapter 11 discharge in a case filed within the preceding eight years.

Exempt property is protected from the debtor’s creditors. Certain dollar amounts of the value of a car, equity in primary residence, household furnishings, clothing, tools of the trade, IRA plans, 401(k) plans, and certain other property are exempt and cannot be used to pay creditors. The trustee’s primary job in a Chapter 7 case is to gather all non-exempt property (if there is any) and sell it to pay creditors. In the majority of cases, the debtor has no non-exempt equity, and there is nothing for the trustee to sell. Not only do trustees have the power to take possession of non-exempt property, they may also, in certain situations, recover money or property transferred to creditors, relatives or friends before the debtor filed the bankruptcy petition. The trustee or other parties of interest may oppose the discharge of the debtor if the debtor has been dishonest or has failed to comply with certain bankruptcy laws.

After the meeting of creditors, the trustee may arrange for the sale of any non-exempt property. Once the trustee has completed such sales and other administrative duties, the trustee prepares a report to the court, and with the court’s approval, distributes funds, if any,