

# Bankruptcy Basics for the Non-Bankruptcy Practitioner

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## Introduction

The goal of this guide is to provide a broad level overview of the key concepts that non-bankruptcy practitioners may need to know when they encounter a bankruptcy proceeding. If you are unfamiliar with bankruptcy and are considering becoming involved in a case, you should reach out to a local bankruptcy practitioner who can advise you about local rules, bankruptcy specific rules of procedure, etc. (See *table of Important Resources* at the end of this document).

## Types of Bankruptcy

There are four types of bankruptcy that you might come across in practice, all of which begin by filing a petition with the bankruptcy court (11 U.S.C. §§ 301, 303) (there are also Chapter 9 filings for municipalities and Chapter 15 filings for certain international proceedings, both of which are extremely rare).

**Chapter 7** – This is the most common type of bankruptcy filing. It predominantly provides debt relief to individuals and married couples. This is a “liquidation” proceeding in which non-exempt assets are sold and the proceeds are distributed to creditors according to the statutory schemes laid out in the Bankruptcy

Code. Even though it is possible for there to be creditor distributions, most Chapter 7 cases are “no asset” cases in which no distributions are made.

Corporations and partnerships can also file Chapter 7 proceedings as an orderly liquidation proceeding, but they do not receive a bankruptcy discharge.

**Chapter 11** – This is primarily a reorganization proceeding used by corporations, that is also available to individuals. A Chapter 11 allows the debtor to restructure its debts while continuing to operate. In most Chapter 11 proceedings, the debtor proposes a plan of reorganization which outlines how creditors will be repaid. To help parties decide whether to vote in favor of the plan, the debtor also files a disclosure statement, which provides creditors and interested parties with information about its operations and financial condition.

There is now a streamlined Chapter 11 proceeding for small businesses under 11 U.S.C. Chapter 11, Subchapter V. These new proceeding became effective February 19, 2020.

**Chapter 13** – Chapter 13 bankruptcy filings are debt repayment plans for individuals and married couples. They allow individuals

to pay eligible creditors over a three-to-five-year time period. The amount that creditors receive is outlined in a plan that is filed by the debtor and confirmed by the Court.

**Chapter 12** – This is a debt repayment plan for family farmers and family fishermen. These proceedings are similar to Chapter 13 proceedings and makeup less than 1% of overall filings.

## Key Dates in the Bankruptcy Filing Timeline

**Filing Date** – The day that a petition is filed with the bankruptcy court the “automatic stay” is generally imposed (with certain exceptions).

**Meeting of Creditors** – The “341 meeting” as required by 11 U.S.C. § 341(a) will be scheduled approximately 31-50 days following the filing. The debtor is required to attend this “341 meeting.” The bankruptcy trustee conducts the meeting and creditors are invited to participate to ask questions of the debtor about their debts and their property.

**Deadlines to Object to Discharge and/or Dischargeability** – Most general unsecured debts will be discharged by a Chapter 7 or a Chapter 13 bankruptcy proceeding. Creditors and other parties in interest can object in two ways. Objections can be filed to the discharge generally – meaning that the debtor would not receive a discharge of any debts (see 11 U.S.C. § 727) or to the dischargeability of a particular debt – meaning that some debts would be discharged and others may not (see 11 U.S.C. § 523). The deadline to make these objections is typically 60 days after the 341 Meeting of Creditors. (See Fed. R. Bank. P. 4004 and 4007).

**Deadlines to Object to Confirmation of Chapter 13 Plan** – Objections to the Chapter 13 plan generally must be filed at least seven days prior to the date of the confirmation hearing (Fed. R. Bank. P. 3015(f)). However, local rules can dictate different deadlines and procedures regarding confirmation and should be consulted.

## The Bankruptcy Estate

**In General** – Property of the bankruptcy estate includes “all legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. § 541(a)(1). If the debtor has any interest in property, realized or contingent, the property should be disclosed on the debtor’s bankruptcy petition. In a Chapter 7 bankruptcy, the estate also includes, with some exceptions, property acquired up to 180 days after the petition filing date. In Chapters 11, 12 and 13, the estate also includes any property acquired by the debtor for the duration of the plan, until the case is closed, dismissed, or converted (see 11 U.S.C., §§ 1115, 1207, 1306).

The extent of the Debtor’s estate is intentionally broad and includes obvious items such as the debtor’s home, car, household goods and bank account balances. It also includes less common categories of property like equitable distribution claims, personal injury claims and ownership of a business. When in doubt, it is always best to disclose the asset. Non-disclosure creates significant risks to the bankruptcy case itself, sometimes resulting in the loss of discharge or a dismissal of the case. A non-disclosed

asset may be administered by a Chapter 7 trustee indefinitely, even if discovered months or years after the closing of the bankruptcy case. The non-disclosure of a claim may also be construed as an admission that no claim exists, judicially estopping the debtor from pursuing an otherwise valid cause of action.

Non-bankruptcy counsel should be mindful of requirements regarding bankruptcy court approval of their employment. Any additional counsel must seek approval to represent the debtor, and also seek approval of the fee agreement. 11 U.S.C. §§ 327 and 330. Depending on the chapter and the local rules unique to each district, the debtor may also be required to obtain approval of the non-bankruptcy settlement. Non-bankruptcy counsel should always consult with the debtor’s attorney when moving forward with any non-bankruptcy causes of action.

**Exemptions** – The debtor may exempt property of the bankruptcy estate, thereby removing the asset from the estate, and protecting the property from the claims of unsecured creditors. The property may be exempted pursuant to federal or state law, depending on the debtor’s domicile at the time of filing and sometimes considering the debtor’s domicile during the 2 years preceding the bankruptcy filing. 11 U.S.C. § 522(b)(3)(A). The proper exemptions are also influenced by whether the domiciliary state has “opted out” of the federal exemptions. As North Carolina is an “opt out” state, a North Carolina domiciliary will usually claim the exemptions contained in N.C.G.S. § 1C-1601(a). North Carolina debtors may claim exemptions under other provisions of the General Statutes as well. For example, N.C.G.S. § 1-362 allows a debtor to exempt funds in an amount equal to his or her wages earned over the previous 60 days, as necessary to support the debtor’s family. The selection of the correct exemptions can have a significant impact on the bankruptcy; the wrong choice may result in the loss of non-exempt property in a Chapter 7 case or an unworkable reorganization plan in Chapter 11, 12 and 13.

The effect of claiming an exemption is to remove the value of that property from the bankruptcy estate, shielding the property from the claims of unsecured creditors. If the available exemption exceeds the value of the asset, the asset is not subject to liquidation in Chapter 7. In other Chapters, the value of the exempt asset is not considered when determining the debtor’s repayment.

## The Automatic Stay

The automatic stay contained in 11 U.S.C. § 362 is the most important protection under the Bankruptcy Code. Among other enumerated safeguards, the automatic stay prohibits creditors from taking any action “against the debtor or property of the estate”, and prevents the creditor from creating, perfecting, or enforcing any lien against property of the estate.” 11 U.S.C. § 362. The automatic stay arises by operation of law upon the filing of the bankruptcy petition and is applicable to all chapters of the Bankruptcy Code. The stay injunction stops lawsuits, collections, repossessions and foreclosure. The stay allows the debtor to resolve debts in a controlled manner, with liquidation of non-exempt property in Chapter 7, and through a plan of reorganization in Chapters 11, 12 or 13.

There are many exceptions to the automatic stay set forth in 11 U.S.C. §362(b). These exceptions include the establishment and enforcement of domestic support obligations, the suspension of

a driver's license, and the creation and enforcement of certain taxes, among many other exceptions. In addition, the stay may be limited or not come into effect at all if the debtor has filed an unsuccessful bankruptcy case within the previous year. 11 U.S.C. § 362(c)(3). The re-filing of a previously dismissed bankruptcy case must be analyzed closely to avoid missing a deadline and losing the debtor's property.

**Relief from the automatic stay** – The automatic stay will remain in place until the earliest of **(a)** the time the case is closed; **(b)** the time the case is dismissed; or **(c)** the time a discharge is granted or denied.

A creditor or party in interest may request relief from the automatic stay or alternatively, a request adequate protection. The grounds for seeking relief are described in 11 U.S.C. § 362(d), and include cause, including lack of adequate protection, absence of equity in the property and lack of necessity for an effective reorganization. Each district has unique rules and guidelines which govern the filing of a motion for relief from stay. Creditor's counsel should review all local rules to ensure the proper format and materials are included in the motion. If the creditor is seeking relief from the co-debtor stay in Chapter 12 or 13, counsel should also review the requirements set forth in 11 U.S.C. §§ 1201 and 1301.

Actions taken in violation of the automatic stay are considered void and can result in serious consequences for the creditor. If the trustee or debtor can establish that the violation was willful, the creditor may be liable for actual damages including attorney fees, and in some cases, punitive damages.

## Filing Claims

Representation of a creditor in a bankruptcy requires in most instances the filing of a proof of claim. The particular mechanics of filing a proof of claim may vary by Judicial District, review of each Court's website and Local Rules for specific requirements and procedures is recommended.

The filing of a claim is accomplished by the completion and filing of Official Form 410 – Proof of Claim, in North Carolina each of the judicial districts permits electronic claim submission. If the claim is based on a written document, Fed. R. Bank. P. 3001(c) requires a copy of that document be included as an attachment to the Proof of Claim. If the claim is secured by property, FRBP 3001(d), requires the claim be accompanied by evidence that the security interest has been perfected. Review of Fed. R. Bank. P. 3001 for specific requirements is highly recommended.

In certain instances, a proof of claim is not required. In Chapter 7 cases, cases where the case is deemed to be a no-asset case no claims are required to be filed as there will be no distribution. If the Court later determines there are assets to be distributed, the Court will transmit a notice of need to file a claim due to recovery of assets.

## Settlement of Disputes Involving Debtors

Another interaction with the Bankruptcy Court that might not be intuitive, relates to the settlement of civil litigation involving Debtors. Whether you represent a party in civil litigation who is also a debtor in bankruptcy or represent the party adverse to the debtor in that litigation, there is a strong possibility that the Bankruptcy Court may have jurisdiction over the dispute. In order to get a settlement approved by the Bankruptcy Court, a motion seeking approval, pursuant to Fed R. Bankr. P. 9019(a) to approve the settlement should be filed within the bankruptcy case.

## Practice Pointers

**Practice Pointer 1** – In order to appear in bankruptcy court, you must be admitted to the federal judicial district in which the Court sits or seek admission under pro hac vice status.

**Practice Pointer 2** – When appearing in bankruptcy court counsel should stand when addressing the Court. When examining witnesses, counsel should do so from a seated position unless there is a need to use courtroom technology. Permission should always be requested prior to approaching the bench or the witness stand when distributing exhibits.

**Practice Pointer 3** – Both 11 U.S.C. § 112 and Fed. R. Bankr. P. 9037 require the redaction of certain sensitive information from bankruptcy filings e.g. social security numbers, full birthdate, names of minors, and a full financial account number. Care should be given to ensure compliance with this rule, especially in attachments to Proof of Claims, as violations even unintentional may result in sanction by the Court. Family lawyers should be particularly cognizant of these rules, as some of this same information often appears in pleadings filed in state court.

**Practice Pointer 4** – The representation of a debtor is a heavily regulated area of bankruptcy law. Fed R. Bankr. P. 2016(b) requires disclosure of all compensation received or agreed to be received in relation to the representation of a debtor; failure to properly disclose compensation can result in disgorgement and/or other sanctions. 11 U.S.C. §§ 526-528 additional requirements on those who provide bankruptcy assistance services; for example, 11 U.S.C. § 528(a)(1) requires the attorney to enter a written contract with the client.

# North Carolina Bankruptcy Filing – Important Resources

(Last updated May 18, 2021)

## Links to General Bankruptcy Information

<a href="#">Bankruptcy Code (11 U.S.C.)</a>	<a href="#">Federal Rules of Bankruptcy Procedure</a>	<a href="#">Bankruptcy Forms</a>	<a href="#">Means Testing</a>
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## Links to North Carolina Bankruptcy Division Specific Information

	WDNC	MDNC	EDNC
<b>Local Rules</b>	<a href="#">WDNC Local Rules</a>	<a href="#">MDNC Local Rules</a>	<a href="#">EDNC Local Rules</a>
<b>Orders</b>	<a href="#">WDNC Orders</a>	<a href="#">MDNC Orders</a>	<a href="#">EDNC Orders</a>
<b>Local Forms</b>	<a href="#">WDNC Local Forms</a>	<a href="#">MDNC Local Forms (Table)</a> <a href="#">MDNC Local Forms</a>	<a href="#">EDNC Local Forms</a>
<b>LMM</b>	<a href="#">WDNC LMM Program</a>	<a href="#">MDNC LMM Program</a>	<a href="#">EDNC LMM Program</a>
<b>Bankruptcy Administrator</b>	<a href="#">WDNC Bankruptcy Administrator</a>	<a href="#">MDNC Bankruptcy Administrator</a>	<a href="#">EDNC Bankruptcy Administrator</a>
<b>District Divisions</b>	<a href="#">WDNC Divisions</a>	<a href="#">MDNC Divisions</a>	<a href="#">EDNC Divisions</a>
<b>Administrative Guide</b>			<a href="#">EDNC Service Guide</a> <a href="#">EDNC Service Guide Addendum</a>