



The Bankruptcy Process

Editor's Note: The following is from a Bankruptcy Process brochure prepared originally by the Bankruptcy Section of the Virginia State Bar but has been updated and edited by Cox Law Group to conform with the significant changes to the Bankruptcy law enacted by Congress in 2005.

1. What Is It—And How Does It Work?

Bankruptcy is a legal process governed by federal rules and procedures contained in the Bankruptcy Code and the Bankruptcy Rules. The primary purpose of bankruptcy law is to provide a debtor with a "fresh start" through which some debts can be paid, restructured or discharged. Bankruptcy also provides a way for creditors to be treated fairly and equitably. The debtor is the person who owes money, goods or services and the creditor is the person to whom the money, goods or services is owed.

A bankruptcy case begins when you pay a filing fee and file a petition with the Bankruptcy Court. Financial information, including a list of all assets and debts, must be provided. *All debtors must certify this information under penalty of perjury.*

As soon as the bankruptcy petition is filed, an "automatic stay" goes into effect. The "automatic stay" generally stops most debt collection efforts against the debtor, unless the bankruptcy court grants the creditor permission to pursue such efforts. The bankruptcy court, and in some cases a bankruptcy trustee, oversees the activities of a debtor until the

debtor obtains an order discharging his debts, and the debtor's case is concluded.

2. Who May File For Bankruptcy?

Almost any person who has a residence, business or property in the United States is eligible to be a debtor under the Bankruptcy Code. Individuals, sole proprietorships, partnerships, corporations and family farmers are eligible for bankruptcy relief. In rare cases, creditors may force someone into bankruptcy by filing an "involuntary petition" against a debtor.

Generally, there are no minimum financial or solvency requirements for the filing of a bankruptcy case by the debtor. Certain debt restrictions or financial requirements apply in Chapter 12 or 13 bankruptcy cases.

3. Do I Have To Go To Court?

In the early stage of a bankruptcy case, the debtor *must* attend a meeting of creditors (also called a Section 341 meeting) at which the debtor must provide information and answer questions under oath from the bankruptcy trustee, the United States Trustee or creditors of the debtor. The bankruptcy judge does not participate in such meetings. Although the meetings are not formal court hearings, testimony is taken under oath and the debtor is subject to criminal penalties for perjury.

Bankruptcy courts are part of the federal judicial system, and federal bankruptcy judges decide most disputes that arise in bankruptcy cases. If any challenges are raised by creditors in an individual's bankruptcy case, it may be necessary for the individual debtor to testify in court. Many of the legal issues and procedures that arise in a typical individual case can be handled by an attorney without requiring the debtor's attendance at bankruptcy court hearings.

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4. How Long Will It Take?

In a Chapter 7 case, the debtor will typically receive an order discharging him from his debts within 3–4 months. Chapter 13 usually requires payments over a 3 year period (with some payment plans extending to 5 years) before a debtor will receive an order discharging him from his debts. There is no established or predictable timetable for completing a bankruptcy case.

5. What Are The Different Kinds Of Bankruptcy Cases?

There are several different types of bankruptcy cases:

- Chapter 7—Liquidation
- Chapter 11—Reorganization (or liquidation)
- Chapter 12—Family Farmer Reorganization
- Chapter 13—Adjustments of Debts of Individual Regular Income

In a Chapter 7 liquidation case, sometimes referred to as “straight bankruptcy,” a trustee is appointed to collect and liquidate the debtor’s non-exempt assets (see below for an explanation of “non-exempt assets”) and to pay the proceeds to creditors in the order set forth in the Bankruptcy Code. Most Chapter 7 cases are “no asset” cases. This means that the debtor does not have sufficient non-exempt assets or sufficient income to make any distribution to unsecured creditors. Unsecured creditors are those who do not have a valid lien on collateral.

Chapter 11 is available to individuals and businesses who seek to reorganize their affairs or to liquidate in an orderly manner. In Chapter 11, the debtor remains in control of his property and operates as a “debtor in possession” subject to bankruptcy court supervision. In Chapter 11, the debtor is

allowed a certain period of time within which to propose a plan of reorganization. The plan of reorganization sets the terms for payment of the debts. The terms of Chapter 11 plans vary depending on the nature of the debt or the type of business the debtor operates, and creditors usually get to vote on the plan.

Chapter 12 allows family farmers with regular annual income to adjust their debts. Generally, the family farmer must have less than \$1.5 million in debts (80% of which must arise out of the farming operation) and at least 50% of the individual’s gross income must come from the farming operation. A family farmer must have regular and stable income that enables him or her to repay his or her creditors under a long term plan.

Chapter 13 is available to individuals with regular income who owe unsecured debts of less than \$307,675 (unsecured debts are debts owed to creditors who do not have liens on any collateral) and secured debts of less than \$922,975 (secured debts are debts subject to valid liens such as mortgages and car loans). These are the figures as of April 2006 and are subject to change by Congress. By choosing Chapter 13, an individual debtor may avoid a Chapter 7 liquidation, stop home mortgage foreclosures, reinstate defaulted home mortgages and obtain a broader discharge of debts than is available in a Chapter 7 liquidation. In exchange, the debtor in a Chapter 13 case must repay unsecured creditors a portion of their claims from the debtor’s future income over a three to five year period. Ordinarily, payments to unsecured creditors will be made by the Chapter 13 Trustee according to the plan filed by the debtor and approved by the bankruptcy judge.

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6. How Does Bankruptcy Help?

Bankruptcy can help a debtor in a number of ways. The filing of a bankruptcy case automatically stops most collection actions against the debtor, such as garnishments, foreclosures and lawsuits, at least temporarily. This allows the debtor to have a “breathing spell” during which the debtor has the opportunity to put his finances in order and chart his financial future. While the bankruptcy case is pending, creditors cannot pursue most actions against debtors without bankruptcy court approval.

The ultimate goal of a bankruptcy filing is to obtain a discharge from certain debts that arose prior to the bankruptcy filing. Once the discharge is obtained, creditors cannot pursue collection efforts against the debtor, and those claims are permanently forgiven unless a lien remains in place or the debtor has “reaffirmed” his obligations to the creditor (see below for a description of reaffirmation of debts). If a lien remains in place, the creditor can pursue the collateral securing the lien even after bankruptcy. If the debtor has reaffirmed a debt, then the creditor can pursue the debtor personally even after bankruptcy. Bankruptcy also affords a debtor an opportunity to reject ongoing obligations under certain types of contracts, recover property or assets that were transferred or seized prior to the bankruptcy case and remove certain kinds of liens.

7. What Property Can A Debtor Keep?

In a Chapter 13, the debtor is generally permitted to retain all of his or her property. In a Chapter 7, however, the Bankruptcy Code allows the individual debtor to retain certain “exempt” property. Exempt property is free of the claims of creditors and cannot be taken by the trustee to be liquidated. With some exceptions for debtors who have not lived

continuously in Virginia for the two years prior to filing bankruptcy, Virginia law determines the types and amount of exempt property.

Under Virginia law, the debtor is entitled to a “homestead exemption” which allows each householder to claim a one-time exemption of up to \$5,000 (plus \$500 for each dependent) in any kind of property. Virginia law also entitles the debtor to a specific exemption, sometimes referred to as the “poor debtor’s exemption,” in different types of property (for example, clothes up to \$1,000; household furnishings up to \$5,000; tools of a person’s trade or business up to \$10,000). Other types of property (such as proceeds from a personal injury settlement or award and certain contributions to qualified pension plans or IRAs) may also be exempt under Virginia law. The debtor must claim the property exempt in his bankruptcy petition and for a claim under the homestead law, he must also properly file a homestead deed within a certain time limit. Creditors or the bankruptcy trustee can challenge the type or amount of the exemption claimed by the debtor.

In a Chapter 7, a debtor may keep property that is subject to the liens of secured creditors as long as the debtor remains current on such obligations and reaches an agreement with the secured creditor. A debtor may “reaffirm” his obligations to a secured creditor who holds a lien on a house, car or other significant item but is not always required to do so. A reaffirmation agreement must be in writing, signed by both the debtor and his attorney, and must be filed with the bankruptcy court prior to the entry of the order granting the debtor’s discharge. A debtor may rescind a reaffirmation agreement within 60 days after signing the agreement. A debtor may also free or “redeem” property from a lien by paying the secured creditor the fair market value of the property in a lump sum. The bankruptcy judge can set the value if the parties do not agree.

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8. What Kinds Of Claims Survive Bankruptcy?

The liens (e.g., car loans, judgment liens recorded in the land records, mortgages, etc.) of secured creditors survive bankruptcy unless the underlying debt is paid off or the lien is avoided during the bankruptcy case. This means the creditor can pursue the collateral (i.e., repossess the vehicle) but the creditor cannot collect against the debtor unless the debt has been reaffirmed. Debts that are reaffirmed during the bankruptcy case will survive.

Some debts cannot be discharged in a bankruptcy case. These nondischargeable debts include recent taxes, alimony or child support obligations, student loans and DUI claims. If a debt is nondischargeable, the debtor is legally obligated to pay the debt even after the bankruptcy filing. Other types of generally nondischargeable debt may be managed or discharged in a Chapter 13 case but not in a Chapter 7 case.

9. What Effect Does Bankruptcy Have On Credit Ratings Or Employment?

A bankruptcy filing can be reflected on a debtor's credit record for up to ten years, regardless of the type or outcome of the bankruptcy case. A bankruptcy filing may also affect a person's ability to borrow money, although the effects of such a filing vary significantly depending on the creditor and the nature of the debt. For example, a person's ability to obtain refinancing on a home mortgage may not be adversely affected by a prior bankruptcy filing as long as payments on similar obligations have remained current. The ability to obtain post-bankruptcy credit or to incur additional debt after a bankruptcy filing may be limited in a Chapter 12 or 13 case because all of the debtor's disposable income must already be committed to repayment of

prior creditors' claims under a plan. Otherwise, there are no legal prohibitions or restrictions against borrowing money, owning property or transacting business after a bankruptcy filing other than the restrictions set forth in the Bankruptcy Code.

Private employers are prohibited from terminating or otherwise discriminating against an individual solely because of a bankruptcy filing. A governmental unit may not terminate or refuse to hire a person solely as a result of a bankruptcy filing. Similarly, a governmental unit may not deny, suspend or refuse to renew a license, permit or similar grant to a debtor as the result of a bankruptcy filing.

10. How Much Does A Bankruptcy Case Cost?

Each bankruptcy case requires a filing fee to be paid to the Court and a fee paid to an approved credit counselor for the mandatory credit briefing required under the recent changes to the bankruptcy law (unless that fee is waived by the counselor due to extreme hardship). The legal fees and costs charged by attorneys to handle a bankruptcy case vary significantly depending on the type and complexity of the case. The bankruptcy court has authority to approve or disapprove fees paid to a bankruptcy lawyer.

With the exception of some particularly complex cases, Cox Law Group generally requires only the Court's filing fee of \$274 plus the credit counseling fees (generally \$50 to \$60) prior to filing a Chapter 13 because the remaining attorney's fees may be paid as a part of the Chapter 13 repayment plan. Fees in Chapter 7 cases vary depending on the complexity of the case. All fees will be discussed prior to filing a bankruptcy at the free, initial consultation with a Cox Law Group attorney.

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