REPRESENTING THE CREDITOR IN CONSUMER AND BUSINESS CASES

John C. Bircher III, White & Allen PA
George F. Sanderson III, Ellis & Winters LLP

INTRODUCTION

Representing a creditor's interests in a bankruptcy proceeding can be a difficult challenge. The Bankruptcy Code substantially modifies both the contractual and statutory rights of creditors. Those modifications are most profound for unsecured creditors, but the Code also alters the rights of secured creditors in meaningful ways as well. A bankruptcy proceeding can, as a practical matter, significantly affect the actual recovery for creditors, secured and unsecured alike. In addition, the Bankruptcy Code contains several traps for the inattentive creditor that can effect a partial or wholesale waiver of a creditors' rights, cause the creditor to be compelled to return money to the bankruptcy estate or, in extreme instances, subject the creditor to sanctions and other penalties.

Set forth below are some of the main issues that arise when representing a creditor in a bankruptcy proceeding. While this is not an exhaustive list of issues that a creditor may encounter, the following provides a survey of the common issues that may arise in the representation of creditors in both consumer and business bankruptcies

I. THE AUTOMATIC STAY

In general, the filing of the debtor's voluntary bankruptcy petition puts into effect an automatic stay of proceedings outside the bankruptcy against the debtor and against the property that constitutes the debtor's bankruptcy estate. The automatic stay broadly prohibits creditors from taking actions to recover debts, or even contact a debtor concerning a debt, during the pendency of a bankruptcy proceeding unless the creditor first obtains relief from the automatic stay.

An act that a creditor takes in violation of the automatic stay is void and may subject a creditor to severe penalties that can include civil penalties, contempt sanctions, and, in certain circumstances, punitive damages.

A. SCOPE

Section 362(a) of the Bankruptcy Code broadly prohibits creditors from taking most types of action to recover against the debtor or against the debtor's property. Actions specifically prohibited after the stay goes into effect include:

--the commencement or continuance of a judicial, administrative, or other proceeding against the debtor, or to recover a claim against the debtor that arose prior to the commencement of the bankruptcy case;

--the enforcement, either against the debtor or property of the estate, obtained before the commence of the bankruptcy case;

--any act to obtain possession of property of, or property from, the estate, or to exercise control over property of the estate;

--any act to create, perfect, or enforce a lien against property of the estate

Section 362(b) explicitly sets forth several categories of actions that are not subject of the automatic stay. Some of the most notable examples include:

--criminal proceedings against the debtor

--actions relating to child custody and visitation

--divorce proceedings (except to the extent that proceeding is to determine division of property of the estate)

--proceedings to enforce alimony and child support obligations

--most acts to perfect or to maintain or continue the perfection of an interest in property

--action by governmental entities to enforce the government unit's police or regulatory power

In light of the breadth of the automatic stay, it is advisable, before a creditor takes action that might have any effect on the debtor or the property of the estate, to examine carefully whether the proposed action would constitute a stay violation. In general, given the penalties that can be imposed on a creditor for a stay violation, it is advisable, when in doubt, for the creditor to seek relief from the automatic stay before proceeding.

2. CO-DEBTOR STAYS

In general, the filing of a bankruptcy petition does not stay actions against a co-debtor. Thus, a creditor can normally still institute collection proceedings against a guarantor or a co-signer on a loan, even if the primary obligor has filed for bankruptcy.

In a Chapter 12 or 13 proceeding, however, sections 1201 and 1301, respectively, provide for an automatic stay of collection proceedings against a co-debtor on a consumer debt, unless the co-debtor became liable on the secured debt in the ordinary course of the co-debtor's business or the case is closed, dismissed, or converted to Chapter 7.

B. EXCEPTIONS TO THE AUTOMATIC STAY

The Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") has added exceptions to the automatic stay's automatically going into effect at the time of the filing of a voluntary bankruptcy petition, and the stay's automatically remaining in effect, in certain instances. Section 362(c)(3) provides that the automatic stay remains in effect for only 30 days after the filing of a petition if the debtor has had a previous petition dismissed within the prior year. See Section 362(c)(4)(A)(i).

The stay does not automatically go into effect at the time that the petition is filed at all if the debtor has had two bankruptcy petitions dismissed in the preceding year, unless the case was refiled pursuant to Section 707(b).

C. RELIEF

In order to proceed against the debtor while the stay remains in effect, a creditor must seek relief from the automatic stay. A creditor seeking relief from the automatic stay must generally bring the request for relief on by motion. A motion for relief from the automatic stay may be combined with an alternative request for adequate protection (which is usually provided in the form of a periodic cash payment to the creditor).

Section 362(e) provides that the automatic stay will be terminated within 30 days after filing the motion for relief unless the court denies the motion within that period. A creditor may consent to the automatic stay's remaining in effect until the date of the hearing on the stay motion in the event that the hearing is set beyond 30 days from the date of filing. The bankruptcy court, after notice and a hearing, may also order the stay to remain in effect pending the conclusion of the final hearing and determination on the motion if the court finds that the party opposing relief is likely to prevail at the hearing.

Section 362 sets forth several grounds on which the court is to consider the granting of relief from the stay. These grounds include that the creditor's interest in the property is not adequately protected, that the debtor has no equity in the property, and that the property is not necessary for the debtor's effective reorganization. The bankruptcy court may also grant relief "for cause" additionally in other circumstances--including the bad faith filing of a case.

The bankruptcy code provides for a theoretically more streamlined relief from stay procedure in bankruptcy proceedings involving "single asset real estate," as the term is defined by the Bankruptcy Code. The court, upon the request of a party in interest and after notice and a hearing, is obliged to grant relief from the stay to a creditor with an interest secured by that real estate, by either the later of 90 days after the entry of order for relief or 30 days after the bankruptcy court has determined that the debtor is a single asset real estate debtor, unless the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed, or determines that the debtor is making adequate monthly interest payments at the then applicable nondefault contract rate of interest to the creditors whose claims are secured by the property.

In the event that the bankruptcy court grants relief from the automatic stay, the creditor must still commence, or continue with, whatever legal proceeding outside of bankruptcy, or other applicable procedure, to obtain the remedy against the debtor, or the debtor's property, that the creditor ultimately desires (i.e. foreclosure, eviction, etc.).

II. PROOFS OF CLAIM

In general, in order to ensure that a creditor's interest against a debtor, or the debtor's property, is protected to the extent possible in the bankruptcy proceeding, the creditor should file a proof of claim in the bankruptcy proceeding. The proof of claim is the document that reflects what the creditor believes the debtors owes on the creditor's claim, and the value of any property that secures it. A creditor must submit whatever

documentation it has to substantiate the amount of the proof of claim, as well as documents sufficient to evidence the existence and perfection of any security interest, in the case of secured claims.

The proof of claim is an essential document for determining a creditors' distribution in a bankruptcy proceeding. A claim is deemed allowed unless a party in interest objects to the claim. An allowed claim will be paid in accordance with the distributions scheme provided in the bankruptcy code or, in Chapter 11, 12, and 13 cases, in accordance with the terms of a court-approved reorganization plan.

The proof of claim also constitutes prima facie evidence of the value of property securing a particular debt, subject to refutation by other competent evidence in an appropriate proceeding. The valuation of a piece of property set forth on the proof of claim may be used to help determine whether a secured creditor's property is adequately protected or lacks equity in a proceeding in a motion for relief from stay, to determine whether a reorganization plan is confirmable, and in other proceedings in the bankruptcy proceeding where property valuation is an issue.

A. TIME FOR FILING PROOF OF CLAIM

In Chapter 7, 12, and 13 cases, a proof of claim for a debt incurred prior to the filing of the bankruptcy petition must be filed within 90 days of the date first set for the initial meeting of creditors, pursuant to Bankruptcy Rule 3003. The time for filing a proof of claim in a Chapter 11 case is to be set by the Court, but each North Carolina district requires proofs of claim to be filed within 90 days of the date first set for the initial meeting of creditors unless otherwise specified.

B. OBJECTIONS TO PROOFS OF CLAIM

In the event that a party in interest disagrees with the amount being claimed, or the treatment that the creditor proposes for a claim, the party in interest may file an objection to claim. An objecting party must set forth, in writing, the grounds for its objection. In the event that a party in interest files an objection to a proof of claim, the creditor filing the proof of claim must file a written response and, generally, the bankruptcy court will hold a hearing to determine the amount of the creditor's claim, whether the claim should be treated as secured or unsecured, and whether the claim should be entitled to a priority status over other particular classes of creditors.

III. PREFERENCES/FRAUDULENT TRANSFER ACTIONS

One of the more frustrating and difficult aspects of bankruptcy to master involves defense of preference and fraudulent transfer actions. Sometimes, there is no defense to the action, and the creditor is left with nothing but a negotiation of the amount owing with no hope of defending the creditor's position. There are defenses, and in the case of a preference action, there are specific statutory defenses found in 11 USC §547(c). It is vital to have a thorough discussion regarding your client's payment policies and

procedures, while also obtaining specific and detailed information relative to your client's recollection of the facts and circumstances surrounding the challenged payment or payments.

A. PREFERENCE ACTIONS

Section 547 of the Code provides the trustee and/or the Debtor in Possession (DIP) the opportunity to avoid certain types of transfers of the debtor's assets, specifically when the creditor was "preferred" over other similarly situated creditors. This cause of action was developed in order to prevent the dismantling of debtor's available assets as the debtor "slides" into bankruptcy. In most cases, a debtor is aware of a significant financial crisis within 90 days of an actual petition filing, and section 547 attempts to balance the potential recovery and distribution of debtor's assets among classes of creditors.

Avoidance of preferential transfers are, for creditors, probably one of the more frustrating causes of action in a bankruptcy case. Imagine being paid in full on a past due obligation by a debtor, only to receive notice of bankruptcy filing by the debtor 89 days later. Creditors that are not familiar with bankruptcy may find it hard to understand why they must return payments made on legitimate debt obligations. There is hope, however, in that section 547 also codifies specific defenses that creditors may raise in defending such actions. In order to effectively explain the concept of a preferential transfer and a creditor's potential defenses, a review and analysis of the specific subsections of 547 is in order.

1. ELEMENTS OF A PREFERENCE

The elements of a preferential transfer are found 11 USC 547(b). They are:

a. A transfer of an interest of the debtor in property;

A transfer is specifically defined in the Code at 11 USC 101(54). A transfer can be, in addition to delivering cash or check, the creation of a lien, the retention of a title as a security interest, foreclosure, or "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with (1) property or (2) an interest in property.

b. To or for the benefit of the creditor;

While generally self-explanatory, this particular element has fostered numerous decisions relating to particular types of creditors. Secured and unsecured creditors, as well as guarantors, have their own specific issues in relation to payments made by insolvent debtors. Secured creditors are not normally subject to preference payments due to other elements, specifically, that the secured creditor would receive more than it would if the case were one under Chapter 7 (using a fair value liquidation analysis). Normally, the secured creditor will receive the property securing the debt or upon sale by the trustee, the secured creditor will be made whole. Therefore, generally speaking, a

payment made to a secured creditor will not be considered a preference. However, certain guarantors may be subject to §547. See *Levit v. Ingersoll-Rand*, 874 F. 2d 1186 (7th Cir. 1989) for a more in-depth discussion of payment to a non-insider creditor during the one year period reserved specifically for "insider" creditors (beginning 91 days from filing).

The *DePrizio* Rule, as it is known, affords the trustee or DIP the ability to recover payments to a non-insider who would normally escape the preference action when there is an insider guarantor of payment that benefits from the debtor's payment to the non-insider. Congress has gone so far as to destroy *DePrizio* through enactment of 547(i). There is ongoing discussion that Congress failed.

c. For or on account of an antecedent debt;

"Antecedent" refers to the preexisting nature of the debt obligation, and limits preferential transfers to debt in existence at or before the filing of the bankruptcy case.

d. Made while the debtor was insolvent;

Simply put, in order for there to be a preference with respect to a certain transfer, the debtor, at the time of the transfer, must have been insolvent. That is, the total amount of the debtor's liabilities are more than the total value of the debtor's assets. Section 547(f) creates a "presumption" of insolvency, which requires the defendant to rebut the initial presumption that 90 days prior to the bankruptcy filing, the debtor's liabilities outnumbered the fair value of the debtor's assets. The trustee or DIP still has the ultimate burden to show insolvency.

e. Made on or within 90 days before the filing of the bankruptcy petition which enables the creditor to receive more than it would have received had the debtor not made the payment and the case was filed under Chapter 7 of the Bankruptcy Code.

As discussed briefly above, the statute's purpose is to avoid the systematic dismantling of the debtor's assets in the debtor's eventual slide into bankruptcy. This subsection requires an analysis by the plaintiff of what the defendant creditor received during the preference period, as well as a liquidation analysis of the debtor to determine whether the defendant creditor received more than it would receive if all the debtor's assets were sold and the proceeds were divided among all creditors in accordance with the Code.

If the creditor received more from the debtor than it would have received if the debtor's assets were liquidated, and if all the other elements of a preference were met, the defendant creditor will most likely have to return the funds received.

B. DEFENSES

The defendant creditor's cause is not completely lost, however, in that congress, in section 547 (c), established a number of defenses to preference claims made by the

trustee or DIP. In addition, there are non-statutory or common law defenses to preference claims as well. Statutory defenses comprise the bulk of the litigation in preference cases, and specific reference to the more prevalent defenses follows:

1. CONTEMPORANEOUS EXCHANGE

Section 547(c)(1) states that a transfer made by the creditor and intended by the debtor and creditor as a contemporaneous exchange for new value, and that the exchange was in fact substantially contemporaneous. The creditor must offer proof of the transaction, establishing the two part test referenced above. *In re Barefoot*, 952 F. 2d 795 (4th Cir. 1991). Proof of this defense will necessarily eliminate the "antecedent debt" prong of the preference analysis.

Issues surrounding contemporaneous exchanges under 547(c)(1) deal specifically with cash and "quasi-cash" transactions – specifically checks. Most of the cases on this defense are fact-specific, focusing on the parties to the transaction and the timing of said transactions, along with the actual "new value" given.

2. ORDINARY COURSE OF BUSINESS

A payment made by a debtor to a creditor will not qualify as a preference if the debt was incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee and the payment was made:

(i) in the ordinary course of business or financial affairs of the debtor and the transferee; or

(ii) made according to ordinary business terms.

The defense of ordinary course also relies heavily on specific facts regarding each transaction. In fact, the factual analysis can be objective or subjective. Objectively speaking, the creditor must establish that the industry standard for the course of dealing between it and the debtor proves that the challenged transaction is one that falls within the standard of dealing in the particular industry in which the debtor and creditor operate. Also, a subjective analysis establishes the course of dealing between the debtor and the defendant. Under pre-BAPCPA law, this analysis was two-fold, requiring a Defendant to establish both prongs of 547(c)(2), however, BAPCPA changed the analysis from an "and" to an "or". Now, a defendant may choose which prong to prove. This is a substantial and significant change from prior law in favor of preference defendants.

3. OTHER DEFENSES

In addition to the above common defenses, § 547(c) enumerates several other defenses, including protection for creditors that extend credit in exchange for a security interest ((c)(3)), creditors that extend subsequent new value ((c)(4), protection for creditors that have security interests in a debtor's receivables or floating inventory (c)(5),

statutory liens ((c)(6)), domestic support obligation payments ((c)(7)), monetary limits for transfers by a consumer debtor for amounts less than $600 ((c)(8)), business case limits of $5,000 for transfers by a non-consumer debtor ((c)(9)).

BAPCPA substantially changed preference cases when it adjusted the venue requirements for certain actions. Through BAPCPA, congress adjusted the debt limits established previously under 28 USC §1409(b) to expand the cases that must be brought in the Defendant's home district. However, there are cases that interpret §1409(b) to exclude avoidance actions, which creates an issue that may be decided by a higher court.

The effect of the amendments makes it more difficult for trustees and DIPs to effectively litigate matters under certain monetary limits, simply because trustees and DIP's may determine that it is not in the best interest of the bankruptcy estate to litigate matters outside the district in which the case is pending.

Before completing this section, it is important to note the number of other defenses not codified, but nevertheless effective in defeating a trustee's or DIP's interest in allegedly preferential payments. These defenses are:

1. Earmarking – this defense requires an agreement between the debtor and creditor that specific funds held by the debtor must be used to pay a specific debt; (ii) that the debtor performed according to the agreement, and (iii) the transfer did not result in the diminution of the debtor's estate.

2. Mere Conduit – when money or property is transferred by the debtor to another, and the person receiving the transfer is not the ultimate beneficiary of the funds transferred, that transferee is a "mere conduit" and one that cannot be held liable for the entire amount transferred. If the conduit keeps any portion of the property transferred, then the conduit may be liable only for the amount kept by the transferee/conduit.

C. FRAUDULENT TRANSFER ACTIONS

Another recovery avenue for trustees and Debtors-in-Possession involves recovery of property transferred that reduced the value of the debtor's estate because the property was transferred for less than fair value. 11 USC § 548 grants a trustee the power to avoid a transfer made within a certain time period that depletes the debtor's estate by lack of adequate consideration or outright fraudulent intent.

Section 548(a) allows a trustee to avoid a transfer that was made within two (2) years before the date of the filing of the petition if the debtor voluntarily, or involuntarily:

(1) made such transfer with actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date of the transfer, indebted; or

(2) (A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(B) (i) was insolvent on the date that such transfer was made, or became insolvent as a result of such transfer or obligation;
(ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;
(iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as debts matured; or
(iv) the debtor made the transfer to an insider, or incurred and obligation for the benefit of an insider, pursuant to an employment contract entered into outside the ordinary course of business.

Clearly, 548(a)(1) is the more challenging prong to prove, as there is the requirement of showing actual intent to hinder, delay or defraud. As with most fraudulent intent cases, the analysis and proof must generally rely on circumstantial evidence to establish a case. Intent is the key factor, and therefore it is extremely rare for the plaintiff to resolve (in its favor) a fraudulent conveyance case at summary judgment.

Generally speaking, most trustees seek to prove fraudulent conveyances through section 548(a)(2), or the constructive fraud standard. Although the burden of proof is less subjective, there are still a number of issues that must be resolved in making a case under this standard. "Reasonably Equivalent Value" is the first hurdle. Case law attempts to define all the areas in which value can be determined, however, certain intangible values hamper attempts to "pin down" valuation of property and of the consideration provided for the transfer. Also, a trustee must consider that the transferee will have a lien on the property transferred to the extent that the transferee delivered consideration of the transfer, no matter how small. This "lien" on the property may be enough to interest the trustee in a cash settlement to resolve the fraudulent transfer issue. Good faith purchasers of property from the initial transferee will also be free from avoidability of the primary transfer – the key phrase being "good faith purchaser".

Insolvency, as with proof requirements in preference actions, requires the plaintiff to prove that the debtor's liabilities are greater than his assets at the time of or as a result of the transfer.

While there are other elements, the above discussion is sufficient to give the non-bankruptcy attorney the initial tools he or she needs to recognize the basic issues in fraudulent transfer litigation.

Before concluding, however, it is important to note that a trustee, through his avoidance powers in 11 USC 544, has the ability to "piggyback" on the North Carolina Fraudulent Transfer Act (very similar to 11 USC 548), which provides a longer lookback period – four (4) years – two years longer than 11 USC 548.

IV. CREDITORS' COMMITTEES

In larger bankruptcy matters, a creditors' committee may effectively protect the rights of classes of smaller creditors. The existence of a creditors committee in a proceeding may also impact, however, other creditors that have elected to actively participate in the bankruptcy proceeding because the creditors' committee often takes the lead in objecting to claims or commencing preference or fraudulent transfer action against those other creditors.

The bankruptcy code authorizes the formation of official creditors' committees for Chapter 7 and Chapter 11 proceedings, but not for Chapter 12 and 13 proceedings. creditors' committees need not be limited to committees protecting the interest of only unsecured creditors, but may be appointed to represent the interests of lien creditors or other types of creditors as long as the proposed group of creditors holds similar claims.

A. FORMATION

In a chapter 7 proceeding, a creditors' committee may form at the initial meeting of creditors. The committee must consist of not less than 3 and not more than 11 creditors holding unsecured claims. If a committee is not constituted at the initial meeting of creditors, no creditors committee will serve during the case.

In a Chapter 11 proceeding, the bankruptcy code requires the United States trustee (here in North Carolina, the bankruptcy administrator), to compose a committee of unsecured creditors, depending on whether there is sufficient interest among the unsecured creditors to form a committee. The Code also empowers the bankruptcy administrator to appoint other creditors committees as she or he deems appropriate. Ordinarily, pursuant to Section 1102(b)(1), the holders of the largest seven claims of the kinds represented on the committee, and that are willing to serve on the committee, are to be appointed members of the committee.

B. DUTIES AND POWERS

In a Chapter 7 proceeding, section 705(b) governs the creditors' committee's powers and empowers the committee to consult with the trustee in connection with the administration of the estate, make recommendations to the trustee regarding the trustee's duties, and submit to the court or the U.S. trustee any question affecting the administration of the estate.

In a Chapter 11 proceeding, section 1103 of the Bankruptcy Code gives a creditors committee broad powers, including:

--the power to consult with the trustee or debtor-in-possession concerning the administration of the case;

--the power to investigate the acts, conduct, assets, liabilities and financial condition of the debtor, the operation of the debtor's business and

the desirability of the continuance of such business, and any other matter relevant to the case or the formulation of a plan;

--the power to participate in the formulation of a plan, advise those represented by such committee of such committee's recommendations as to any plan formulated, and collect and file with the court acceptances or rejections of a plan;

--the power to request the appointment of a trustee or examiner under section 1104, if a trustee or examiner, as the case may be, has not previously been appointed in the case;

--the power to perform such other services as are in the interest of those represented.

11 U.S.C § 1103(c).

In addition to the other enumerated powers, a creditors committee, as a party in interest, may object to claims filed by other creditors. A creditors committee may also commence adversary proceedings, including preference and/or fraudulent transfer actions, against other creditors or parties with whom the debtor conducted business.

C. COMPENSATION

A creditors committee is authorized to employ professionals, including attorneys and accountants. There is less certainty, however, that a committee will be compensated for the employment of professionals in a Chapter 7 proceeding than in a Chapter 11 proceeding.

There is no explicit provision for compensation of a creditors committee in a Chapter 7 proceeding. Under Sections 503 and 507 of the bankruptcy code, a creditors committee is authorized to seek compensation, as a first priority administrative expense, for reimbursement of the reasonable and necessary expenses incurred in recovering property transferred out of the bankruptcy estate, or that is concealed by the debtor and recovered for the benefit of the estate. An application for reimbursement of professional fees incurred in the pursuit of such activities is presumably authorized under those sections of the Code.

Section 328(a) of the bankruptcy code explicitly permits an appointed Chapter 11 creditors committee to employ professionals, including attorneys, accountants, as well as other professionals as the case circumstances warrant. Actual compensation of the committee professionals is subject to review and approval by the Court.

V. LIEN AVOIDANCE ACTIONS

11 USC 522 is a formidable weapon in the debtor's arsenal. This particular statute is effective in depriving a secured creditor of any type of security if certain criteria are met. While the first five sections of section 522 set forth the federal exemptions,

522(f) and (g) subject creditors to potential elimination of a security position in collateral held by a secured creditor. Without quoting each section word for word, a summary follows. Subsection (f) provides:

> (1). . . the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled, if such lien is –
>
> (A) a judicial lien. . .; or
> (B) a non-possessory, non purchase money security interest in any-
> i. household furnishings. . . etc, that are held primarily for the personal, family, or household use of the debtor or dependent of the debtor;
> ii. implements, professional books or tools of the trade. . .;
> iii. professionally prescribed health aids. . .

For purposes of lien avoidance, a lien impairs an exemption to the extent that the sum of: the lien, all other liens on the property, and the amount of the exemption that the debtor's interest in the property would have in the absence of other liens – exceeds the value of the debtor's interest in the property.

Obviously, valuation evidence is key in determining whether liens are avoided, and therefore creditors must analyze whether it is worth hiring an appraiser or other professional to testify before the court that the property in question has sufficient value to protect the judgment lien, that is, value over and above all liens, the lien in question, and the debtor's exemptions. In most cases, bankruptcy attorneys can sufficiently estimate what value is present in the debtor's property, and more often than not, motions to avoid liens are left unchallenged by creditors, simply because the cost of defending the lien is significant, considering the risk of insufficient value present.

11 USC 522(g) provides a debtor the opportunity to avoid any transfer that a trustee failed to avoid under 11 USC 544, 545, 547, 548, 549, or 553. The debtor is limited, however, to the amount that the debtor could have exempted property if the trustee had avoided the transfer.

VI. OBJECTIONS TO EXEMPTIONS

Under 11 USC 522, debtors in bankruptcy are allowed to exempt certain property from attachment, collection or turnover by a trustee. The purpose of the exemption statutes are to afford the debtor the opportunity of a fresh start, and not leave him penniless, homeless, without basic necessities with which to implement recovery from bankruptcy. North Carolina has opted out of the federal exemption system, and therefore all debtors in North Carolina (with some exceptions depending upon residency requirements) must use 1C-1601(a) of the North Carolina General Statutes in establishing exemptions.

With the enactment of BAPCPA, Congress attempted to "close the loophole" on debtors attempting to "forum shop" for the most advantageous exemption structure, as in Florida and Texas, states which have an unlimited homestead exemption. BAPCPA further complicated this process through its tricky and cumbersome domicile requirements. Prior to BAPCPA, a debtor would determine his exemptions based upon his domicile during the 180 days prior to filing or domicile for the longer period in which he resided during the 180 days.

BAPCPA attempted to close the "Enron" loophole with regard to unlimited homestead exemptions. Instead of a 180 day requirement, the debtor may use the exemptions of the state or jurisdiction where he was domiciled for the 730 day period prior to the filing of the petition. If the debtor was not in one place for the entire 730 days, then the debtor must use the exemptions from the state in which the debtor was domiciled for the 180 day period before the 730 day period.

This causes many problems for certain debtors in that many stated require a debtor to reside in the state at the time of taking the exemption to actually utilize the exemptions from that state. Thus, the federal exemptions may come into play, as federal exemptions are the "fallback" exemptions for debtors without an exemption "home".

As stated above, N.C. Gen. Stat. 1C-1601(a) sets forth the majority of the exemptions to which debtors are entitled. Without reprinting all the exemptions here, it is clear that a creditor needs to understand and appreciate the exemption statutes to effectively represent creditors in bankruptcy matters.

Under Bankruptcy Rule 4003, a trustee, creditor or other party in interest may object to a debtor's exemptions, however, one cannot sleep on one's rights. The debtor's exemptions become fixed thirty (30) days after the conclusion of the debtor's creditor's meeting.

VII. OBJECTIONS TO DISCHARGE

Another extremely useful tool for creditors (and one to which debtors pay close attention) is potential objections to discharge and to dischargeability of debts. The whole purpose for which a debtor files bankruptcy and wades through the process is to obtain a fresh start and have his debts discharged. The last thing any debtor wants is to go through the process only to lose his discharge or have certain debts survive the bankruptcy process. There are specific statutes governing discharge and dischargeability, and each chapter has specific statutes covering the discharge, while section 523 (which applies to all chapters) governs dischargeability of certain types of debts.

A. GROUNDS

In chapter 7 cases, 727(a) sets forth ten (10) separate grounds for denial of discharge. Most of the grounds revolve around the failure of the debtor to honestly

conduct himself through the process (such as failure to explain loss of assets, inadequate financial records, and fraudulent transfers or concealment of property). Other grounds are time-specific, such as receipt of a previous discharge within 6 years, in a chapter 7 or 11 case.

In order to object to a debtor's discharge, a creditor must initiate an adversary proceeding, governed by Bankruptcy Rule 7001, et seq.

In chapter 11 cases, once a debtor receives an order of confirmation, debts incurred pre-petition are discharged, however, the debts and obligations created under the debtor's plan of reorganization are not discharged until the debtor completes the plan payments per the order of confirmation, unless the court orders otherwise.

There are exceptions to discharge in Chapter 11, and as to individual debtors, a discharge under chapter 11 does not discharge a debtor from any debt excepted under section 523. 11 USC 523 specifically sets forth a number of exceptions to discharge, and also provides creditors a framework for potentially objecting to the dischargeability of its debt.

Chapters 12 and 13 also provide for chapter-specific exceptions to discharge, however as with chapters 7 & 11, Section 523 applies to all chapters.

Section 523(a) provides for 19 different exceptions to discharge, and if proven in favor of the creditor, that specific debt will survive the bankruptcy process, allowing the creditor to continue with collection on the excepted debt, more than likely without interference with other debts or obligations that have been discharged. This means that the creditor is likely to collect (or create leverage against the debtor) on debt that survives, and also demonstrates the importance of investigation and review of the debtor's petition and schedules as well as the creditor's file to determine if an adversary proceeding objecting to the dischargeability of certain debts is appropriate.

The 523(a) exceptions are as follows:

(1) certain taxes;
(2) debts incurred through fraud;
(3) unlisted claims;
(4) embezzlement/larceny;
(5) domestic support obligations;
(6) willful and malicious injury;
(7) fines, penalties & forfeitures;
(8) student loans;
(9) DWI debts;
(10) debts from denial of discharge in previous bankruptcy;
(11) fiduciary fraud debts;
(12) Malicious failure to fulfill FDIC commitments;
(13) restitution under title 18;

(14) debt incurred to pay nondischargeable federal tax
(14A) tax to gov't unit other than federal
(14B) Federal Election Law penalty
(15) debts incurred in separation or divorce to a spouse, former spouse or child;
(16) postpetition HOA assessments;
(17) court fees
(18) social security act support payments;
(19) securities laws violations;

B. TIMING

Each of the above exceptions to discharge may be raised at any time, even after the close of the bankruptcy case, except for 523(a)(2), (4) and (6). For those specific subsections, the creditor must commence an adversary proceeding within 60 days after the date first set for the meeting of creditors. Creditors may request an extension of time to file a complaint, however, the extension must be filed within the initial 60 day window to be effective.

VIII. REAFFIRMATION AGREEMENTS

A claim that has been discharged in bankruptcy can be reaffirmed at the debtor's election. Given that the ultimate "reward" given to a debtor for successfully going through a bankruptcy proceeding is the grant of a discharge, reaffirmation agreements are generally subject to much skepticism.

Section 524 erects many hurdles for the debtor to enter into a binding reaffirmation agreement. In order for the reaffirmation agreement to be enforceable, the agreement must meet the following requirements of Section 524(c):

--the agreement must have been entered into prior to the granting of a discharge;

--the debtor must receive the extensive disclosures concerning the agreement that are now required by Section 524(k);

--the reaffirmation agreement must be accompanied by an affidavit of the debtor's attorney, assuming that the debtor had an attorney aid the debtor in negotiating the reaffirmation agreement, reciting that the agreement represents a fully informed and voluntary agreement by the debtor, that the agreement does not impose an undue hardship on the debtor or a dependant of the debtor, and the attorney fully advised the debtor of the legal effect and consequences of such an agreement and any default under the agreement;

--the debtor must not have rescinded the agreement at any time prior to discharge, or within 60 days after such agreement is filed with the court, whichever is later;

--where the debtor is not represented in negotiating the reaffirmation agreement, the Court must approve the agreement as not imposing an undue hardship on the debtor or a dependent of the debtor and find that the agreement is in the best interest of the debtor.

BAPCPA added provisions to the bankruptcy code, including the imposition of the Section 524(k) disclosure requirements, that make court approval of a reaffirmation agreement more onerous and more speculative than before.

CONCLUSION

The practice of bankruptcy law is interesting, challenging and generally rewarding, however, it can be equally as frustrating for creditors that are not familiar with the process, and very dangerous for the practitioner who does not pay close attention to deadlines, processes and procedures specific to bankruptcy cases. As one can see from this brief overview of general topics, there are many pitfalls for the unwary practitioner as one weaves their way through the complex and unforgiving world of bankruptcy. While we encourage fellow attorneys to explore bankruptcy concepts, to ensure the best protection for your creditor client, consult a certified specialist or a practitioner that concentrates in bankruptcy for assistance and association in your case.