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Bankruptcy Basics for the Non-Bankruptcy Lawyer
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Richard A. Marshack, Esq.

Richard A. Marshack is a founding member of Marshack Hays LLP. Mr. Marshack has been an attorney and bankruptcy trustee for over twenty-five years.

He was born in Las Vegas, Nevada and graduated from University of California at Irvine in 1979 with a Bachelor of Arts degree and from California Western School of Law in 1982 (Magna Cum Laude). Mr. Marshack received numerous achievement awards, including: Recipient, American Jurisprudence Award: Agency and Partnership. He was also a Staff Writer, 1980-1981, and Lead Articles Editor, 1981-1982, for the California Western Law Review. He was admitted to the California Bar in 1982 and the U. S. District Court, Central and Southern Districts of California and U.S. Court of Appeals, Ninth Circuit in 1984.

He has authored several articles, including: "The Toxic Claim: Using Bankruptcy Law to Limit Environmental Liabilities," California Bankruptcy Journal, Volume 19, Number 3, 1991; "Recent Developments Under Section 546 of the Bankruptcy Code," Tactics for Unsecured Creditors of Bankrupt Debtors," California Lawyer 21, August, 1984; "Adequate Protection for the Unsecured Creditor Under the Bankruptcy Code", Commercial Law Journal 621, December 1983; "Recent Developments for Reclaiming Goods Under the Bankruptcy Code and the Uniform Commercial Code, "Uniform Commercial Code Law Journal 187, July, 1983; "Reclamation of Goods Under the Bankruptcy Code," Oregon Debtor-Creditor News Letter, I, July 1983; "Sindell vs. Abbot Laboratories: Is Market Share Liability the Best Remedy to the DES Controversy" California Western Law Review 143, 1981.

D. Edward Hays, Esq.

D. Edward Hays is a founding member of Marshack Hays LLP and has been a practicing attorney for nineteen years.

He was born in Los Angeles, California and graduated with honors from California State University at Fullerton in 1989 with a Bachelor of Arts degree in Business. He graduated from the University of Southern California Law Center in 1992 where he was a member of the Hale Moot Court Honors program. Mr. Hays was admitted to practice law in California in 1992.

¹ Richard and Ed would like to recognize Sarah C. Boone, associate attorney with Marshack Hays LLP, for her contribution to these written materials.

Mr. Hays currently serves on the Board of Directors for the following organizations: Legal Aid Society of Orange County; University of Southern California Law School Annual Fund; and Cal State University Fullerton Philanthropic Foundation.

In 2004-2005, Mr. Hays served as the President of the Cal State Fullerton Alumni Association and was selected that year as a CSUF Volunteer of the Year. In 2004, Mr. Hays was the Chair of the Resolutions Committee for the Orange County Bar Association and has served as a delegate to the State Bar Conference on behalf of Orange County every year since 1995. In 2000, Mr. Hays was the Chair of the Commercial Law & Bankruptcy Section of the Orange County Bar Association. Mr. Hays also has served as a Director or member of the following organizations: the Inland Empire Bankruptcy Forum; the Orange County Bankruptcy Forum; the William P. Gray Legion Lex American Inns of Court, the Federal Bar Association and the Executive Council for the College of Business at Cal State Fullerton. In 1998 and 1999, Mr. Hays also served as a Judge Pro Tem for the Superior Court of the State of California, County of Los Angeles.

He has been selected on numerous occasions to present lectures on various legal topics including bankruptcy, exemptions and legal research. He also served on a Central District Task Force for Amendments to the Local Bankruptcy Rules.

Mr. Hays has numerous published cases, including: *In re Continental Capital & Credit*, 158 B.R. 828 (Bankr. C.D.Cal. 1993); *In re Turner*, 186 B.R. 108 (9th Cir. BAP 1995); *In re National Environmental Waste Corporation*, 191 B.R. 832 (Bankr. C.D.Cal. 1996) *aff'd* 129 F.3d 1052 (9th Cir. 1997); *In re Metz*, 225 B.R. 173 (9th Cir. BAP 1998); *Blonder v. Cumberland Engineering*, (1999) 71 Cal.App.4th 1057, 84 Cal.Rptr.2d 216; *In re Kuraishi*, 237 B.R. 172 (Bankr. C.D.Cal. 1999); *In re Kim*, 257 B.R. 680 (9th Cir. BAP 2000); *In re Dudley*, 249 F.3d 1170 (9th Cir. 2001); and *In re Dick Cepek*, 339 B.R. 730 (9th Cir. BAP 2006); *In re Four Star*, B.R. (Bankr. C.D. Cal. 2011); and *In re Rinard*, B.R. (Bankr. C.D. Cal. 20110).

I. INTRODUCTION

A. Purpose of Bankruptcy

1. Fresh start for debtors; and
2. Breathing room from creditors.

B. Warning: The Pitfalls of Bankruptcy

1. Complex code-based law with a heavy interrelation with the various Federal and Local Rules.
2. Recent bankruptcies can affect the automatic stay and the debtor's right to a discharge.
3. In Chapter 11 in particular, the first week of bankruptcy is document- and filing-intensive and comprises multiple important deadlines
4. Debtor comprehension of the effect of a Chapter 7—what happens to a debtor's property and what a Chapter 7 can and cannot accomplish—is often imperfect.

II. GOVERNING LAW

C. Title 11 of the United States Code²

1. Chapters 1, 3, and 5 apply to all cases; and
2. Chapters 7, 9, 11, 12, 13, and 15 apply to specific types of cases.
3. Title 11 available on multiple internet sites

- a) US House of Representatives:

http://uscode.house.gov/download/title_11.shtml

- b) Cornell Law School

http://www.law.cornell.edu/uscode/html/uscode11/usc_sup_01_11.html

D. Property rights are determined by state law. *Butner v. United States* (1970) 440 U.S. 48.

1. California Law available on multiple websites

<http://www.leginfo.ca.gov/calaw.html>

² There is technically no such thing as the “Bankruptcy Code,” but practitioners and laymen alike often refer to Title 11 as the Bankruptcy Code. We generally do not.

- E. Federal Rules of Bankruptcy Procedure (“FRBP”) is an Appendix to Title 11 of the United States Code.
1. FRBP available on multiple websites
 - a) United States Court
<http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK-Rules.pdf>
 - b) Cornell Law School
http://www.law.cornell.edu/uscode/html/uscode11a/usc_sup_05_11_10_sq1.html
- F. Federal Rules of Civil Procedure often apply in bankruptcy cases.
http://www.law.cornell.edu/uscode/html/uscode28a/usc_sup_05_28_10_sq4.html
- G. Federal Rules of Evidence apply in bankruptcy cases
http://www.law.cornell.edu/uscode/html/uscode28a/usc_sup_10_sq5.html
- H. Local Bankruptcy Rules are available on the Court’s website www.cacb.uscourts.gov
- I. Local-Local Rules (aka Individual Practices). See, “Information” tab on court’s website for particular rules and requirements which can vary by Judge. www.cacb.uscourts.gov
- J. Self-Calendaring: Most of the judges post available hearing dates for self-calendaring.
- K. Forms. Many motions require use of mandatory forms available on the court’s website.
- L. The United States Trustee Program (the “US Trustee”) is a component of the Department of Justice responsible for overseeing the administration of bankruptcy cases and private trustees under [28 U.S.C. §586](#) and [11 U.S.C. §101](#), *et seq.* The US Trustee is charged with a duty to ensure that Chapter 7 Debtors pass the means test, that attorneys and paralegals not charge unreasonable fees, etc. Bankruptcy practitioners should be familiar with the US Trustee’s rules and regulations which can be viewed at <http://www.justice.gov/ust>

III. OTHER HELPFUL INFORMATION RE: BANKRUPTCY PRACTICE

- A. United States Bankruptcy Court for the Central District of California:
www.cacb.uscourts.gov

- B. Tentative Rulings are generally posted to the Court’s website the evening before hearings.
1. Computer Web Access: <http://ecf-ciao.cacb.uscourts.gov/CiaoPosted>
 2. Mobile Device Access: <http://ecf-ciao.cacb.uscourts.gov/tr>
- C. High-speed Wi-Fi in Courtrooms provided by the Bankruptcy Court to all registered users of Electronic Case Files (“ECF”). To obtain the access code, ECF users can call 213-894-2365.
- D. Public Access to Court Electronic Records (“PACER”) provides access to dockets and pleadings for federal courts across the country. Users must set up an account to access. <http://www.pacer.gov/psco/cgi-bin/links.pl>

IV. COMMENCING BANKRUPTCY CASES

- A. Voluntary vs. Involuntary Petition
1. Voluntary cases are filed by a petition signed by debtor under penalty of perjury. [11 U.S.C. § 301](#).
 - a) Eligibility: Generally, any “person” who “resides or has a domicile, a place of business, or property in the United States” can file. [11 U.S.C. § 109\(a\)](#). “Persons” include individuals, corporations, partnerships, LLC’s, etc. Requires authorizations such as a corporate resolution, etc.
 - b) Consumer Debtors: Individuals whose debts are primarily consumer must obtain credit counseling prior to filing.
 2. Involuntary cases are filed by creditors against an alleged debtor.
 - a) Creditor remedy to force debtor into a Chapter 7 or Chapter 11.
 - b) Commenced by filing of petition for order for relief. [11 U.S.C. § 303](#).
 - c) Grounds: (1) alleged debtor generally not paying debts as they become due; or (2) within 120 days a custodian or receiver was appointed or took possession of substantially all of the alleged debtor’s property.
 - d) Number of Petitioning Creditors. If debtor has fewer than 12 creditors,

then any single creditor holding an unsecured or undersecured claim of at least \$14,425 that is not contingent as to liability or subject to *bona fide* dispute may sign the petition. If the debtor has more than 12 creditors, then three creditors must sign the petition.

❖ Practitioner's Note: The free online resources, including those cited in this outline, are *often out of date* with respect to current applicable dollar amounts. These include the amounts for California exemptions (*see* below) and the [11 U.S.C. § 303\(b\)\(2\)](#) undersecured claim amount. Always be careful to double check your dollar figures for recent changes.

- e) If debtor defeats petition, then petitioning creditors subject to paying attorneys' fees of alleged debtor.

B. Pre-Bankruptcy Thoughts

1. Query whether bankruptcy is appropriate or whether your client should be considering out-of-court workouts (*see* below).
2. Be aware of filing options, including emergency petitions.
3. Be aware of the documents required to be filed for the different Chapters, including which must be filed on the petition date and which, in the case of emergency filing, may be filed within specified periods after the petition date.
4. For a Chapter 7, ensure that your client is fully aware of the consequences of her filing and her chapter election.
5. For a Chapter 11, ensure you have your first-day motions lined up as well as your required petition documents before you pull the trigger. Ensure that your client is aware of the sometimes onerous responsibilities of a debtor-in-possession and the fiduciary duties she is taking on.
6. Be aware of the counseling requirements and ensure your client is prepared to meet them:

- a. Pre-Petition Counseling. Client must have completed credit counseling within the 180-day period prior to bankruptcy from an approved credit counseling agency, or her case will be dismissed (certain exceptions exist, but they are almost never applicable). [See 11 U.S.C. § 109 \(h\)\(1\)](#).
- b. Post-Petition Pre-Discharge Counseling. Client must complete a financial management after the filing of her petition, or her discharge will be withheld.

C. Chapter 7 - Liquidation

1. Summary: Trustee appointed to liquidate assets to pay creditors. Chapter 7 cases are typically filed by individuals seeking to discharge pre-bankruptcy debts. Liens survive bankruptcy.
2. Qualifications - Means Test. Individuals whose debts are primarily consumer must make less than the median income for their state of residence. California's current median income for a one-person household is \$47k and for a four-person household is \$77k. Based on last six full months multiplied by two. Because the figures change, practitioners should always check the current amounts. A chart is available on the website for the United States Trustee Program at the following website:
http://www.justice.gov/ust/eo/bapcpa/20101101/bci_data/median_income_table.htm

D. Chapter 11 - Reorganization

1. Summary: Debtor remains in possession (i.e. no trustee automatically appointed). Chapter 11 cases are typically filed by individuals or businesses with complex financial issues and substantial amounts of creditors. Chapter 11 cases are very expensive.
2. Qualifications. There are generally no debt or income limits for Chapter 11 debtors.

E. Chapter 13 – Individual Debt Adjustment

1. Summary. Individuals with regular income seek to confirm a plan to repay creditors over a maximum of five years. Typically, Chapter 13 cases are filed by individuals seeking to reinstate mortgage defaults over time.
2. Limited to individuals with regular income. Current debt limitations are \$360,475 of unsecured debt; and \$1,081,400 in secured debt. Current limitations posted at: <http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter13.aspx>
These debt limitations are adjusted every three years. Next adjustment is April 1, 2013. Debt limits are jurisdictional.

V. THE BANKRUPTCY ESTATE

- A. Property of Estate: All of the debtor’s legal and equitable interests in property “as of the commencement of the case.” [11 U.S.C. § 541\(a\)](#). Broadly defined and includes contract rights, causes of action, etc.
1. Post-petition wages: Included in Chapters 11 and 13. Not in Chapter 7;
 2. Community property is property of estate. Even if an asset held only in name of non-filing spouse.
 3. Joint tenancy / Separate Property. If property held in joint tenancy, each spouse deemed to have a one-half separate property interest.
 4. Property Inherited Post-Petition. Property acquired by a Chapter 7 debtor within 180 days after petition date through a bequest, devise, or inheritance.
❖ Practitioner’s Note: 180 day limit may not apply to Chapter 13 debtors.
- B. Exclusions from Property of Estate. [11 U.S.C. § 541\(c\)\(2\)](#) excludes property held in trust that contains restriction on transfer enforceable under applicable non-bankruptcy law. Thus, ERISA-qualified pension plans or spendthrift trusts can be excluded from estate.

VI. EXEMPTIONS

A. Exempt property is not subject to administration by a trustee. [11 U.S.C. § 522\(c\)](#).

Technically, exempt property is removed from the estate (compare to excluded property, which never comes into the estate).

1. Exemptions Limited to Individuals. Only individuals are entitled to exempt property (i.e. not businesses).
2. Opt-out. Title 11 provides that states can opt out of federal exemptions and provide for state exemptions to be applicable in bankruptcy cases. [11 U.S.C. § 522](#). California has opted out. Thus, California exemptions under either [CCP § 703.140](#) (the wildcard section) or [CCP §§ 704 et seq.](#) (the homestead sections) apply. Title 11 also provides that the first \$1 million of a retirement account is exempt pursuant to [11 U.S.C. § 522](#).
3. List of Most Common Exemptions and Amounts. The Judicial Council maintains a [list of the most common exemptions and their current amounts](#).
4. Specific exemptions.
 - a) Homestead. As of January 1, 2010, amounts increased. \$75,000 for single individuals; \$100,000 for family units; and \$175,000 for seniors and disabled individuals. *See, e.g.* [CCP § 704.730](#). Applies to individual's interest in property even if only a one-half joint tenancy interest. Different treatment for recorded declarations of homestead.
 - ❖ Practitioner's Note: *Six month exemption for proceeds of sale apply only if a declaration of homestead had been recorded.* [CCP § 704.760](#).
 - b) Retirement Accounts. \$1 million if tax qualified plan. [11 U.S.C. § 522\(n\)](#). Must be used principally for retirement purposes. [In re Dudley](#), [249 F.3d 1170 \(9th Cir. 2001\)](#).

- c) Life insurance policies. Cash value exemption limited to \$11,475 per debtor. [CCP § 704.100](#).
 - d) Spendthrift trusts. 75% of interest in qualified spendthrift trust is excluded from estate under [11 U.S.C. § 541\(c\)\(2\)](#). Remaining 25% potentially exempt under California, [Probate Code §§ 15300 et seq.](#) and [CCP Section 709.010](#). A detailed analysis of the [Treatment of Spendthrift Trusts is available on the Marshack Hays LLP website](#).
5. Objections to Exemptions. Any party in interest, including creditors or the Trustee, can file an objection to a debtor's claimed exemptions. Usually, objection must be filed within 30 days after the conclusion of the §341(a) meeting of creditors or within 30 days after the debtor files an amended Schedule C (the exemptions schedule). Further time may be granted by the Court. Other deadlines apply in certain unusual circumstances. See [FRBP 4003](#).

VII. THE AUTOMATIC STAY

- A. Injunction. The filing of the bankruptcy creates an automatic stay. [11 U.S.C. § 362\(a\)](#). The stay generally prohibits creditors from enforcing pre-bankruptcy claims or from exercising control over estate property. The purpose of the stay is to give the debtor breathing room and to preserve the estate for orderly and pro rata distributions.
- 1. Arises automatically.
 - 2. Creditors have affirmative duty to cease enforcing claims.
 - 3. Violations subject offending party to sanctions. [11 U.S.C. § 362\(k\)](#) which provides that the court "shall" award "actual damages" including costs and attorneys' fees to an "individual" injured by a willful violation of the stay. "Individual" does not include corporations, partnerships or bankruptcy trustees. Recoverable attorneys' fees do not include the fees for proving up violation of stay.
 - 4. Actions that violate the stay are void and not voidable.

5. Exceptions to automatic stay found in [11 U.S.C. § 362\(b\)](#). Does not enjoin criminal prosecutions, certain family law issues including custody and visitation, and police powers.
6. Duration of Stay as to Estate Property. With regard to estate property, the stay “continues until such property is no longer property of the estate.” [11 U.S.C. § 362\(c\)\(1\)](#). Property ceases to be property of the estate after it is sold, abandoned or exempted.
7. Duration of Stay as to Debtor or Debtor’s Property. Stay terminates upon case being closed or dismissed. Also, with regard to individual debtors, the stay terminates after the debtor is granted or denied a discharge. [11 U.S.C. § 362\(c\)\(2\)](#).
8. Relief from Stay. A creditor can file a motion for seeking a court order granting relief from stay for such things including foreclosure or continuation of a non-bankruptcy action.

VIII. DISCHARGE

- A. General Discharge. [11 U.S.C. § 727](#) provides that all qualified individual debtors are entitled to discharge of debts unless timely complaint filed and judgment entered denying discharge. Purpose of discharge is to provide a fresh start to honest but unfortunate debtors.
 1. Grounds include: (a) false oaths; (b) transfer of assets within one year with actual intent to hinder, delay or defraud creditors; and (c) failure to explain dissipation of assets.
 2. Burden of proof on creditor.
 3. No pre-petition waivers of discharge.
 4. Only one discharge every 8 years measured from petition date.
 5. Liens survive bankruptcy even if debtor discharges debt.

6. Discharge generally does not extend to non-debtors. Compare to community property discharge under [11 U.S.C. § 524\(a\)\(3\)](#).
 7. Discharge is actually a permanent injunction against enforcement.
 8. Enforceable by contempt.
- B. Exceptions to Discharge. [11 U.S.C. § 523](#) provides that certain debts are not discharged.
1. Fraud. [11 U.S.C. § 523\(a\)\(2\)](#).
 2. Breach of fiduciary duty. [11 U.S.C. § 523\(a\)\(4\)](#).
 3. Willful and malicious injury. [11 U.S.C. § 523\(a\)\(6\)](#).
 4. Domestic Support. Automatically non-dischargeable in all chapters per [11 U.S.C. § 523\(a\)\(5\)](#).
 5. Non-Support Awards to former spouses not dischargeable in any chapter except in Chapter 13 after entry of a full compliance discharge per [11 U.S.C. § 523\(a\)\(15\)](#).

IX. LITIGATION

- A. Adversary Proceedings v. Contested Matters: The Groundwork. There are two basic types of litigation in Bankruptcy Court: Adversary Proceedings and contested matters.
1. Adversary Proceedings are separate lawsuits filed in the bankruptcy court and related to but not consolidated with the underlying bankruptcy proceeding. (1:11-ap-12345-SC v. 1:11-bk-54321-SC). What constitutes an adversary proceeding (as opposed to what can be resolved by contested matter) is governed by [FRBP 7001](#).
 2. Contested Matters are what we would commonly call motion practice within the underlying bankruptcy itself. Procedural issues for contested matters are addressed at [FRBP 9014](#).
- B. Adversary Proceedings.
1. Discharge. Any party in interest may bring an adversary proceeding for determination of dischargeability of a particular debt, also known as exceptions

to discharge ([11 U.S.C. § 523](#), *see* discussion above) or for denial or revocation of the debtor's discharge ([11 U.S.C. § 727](#), *see* discussion above).

- ❖ Practitioner's Note: Knowing the causes of action and elements for exception to discharge, denial of discharge, and revocation of discharge can help you advise a client pre-petition what her risks in bankruptcy may be. It will also assist you in formulating a set of guidelines for your client: having clear do's and don'ts both before and after her filing will keep your client on track and may help keep you out of a malpractice suit.

2. Avoidance Actions and Trustee's Strong-Arm Powers

- a. Strong-arm powers. [11 U.S.C. § 544\(a\)](#) gives trustee powers of hypothetical judicial lien creditor or hypothetical bona fide purchaser of real property. Can be used to defeat unperfected liens or interests.
- b. Preferences. [11 U.S.C. § 547\(b\)](#) provides that a trustee or debtor-in-possession can avoid a transfer of an interest of a debtor in property, on account of an antecedent debt, that allows the creditor to recover more than under a chapter 7. Non-insiders subject to a 90 day reach-back. Insiders subject to a one year reach-back.
 - i. Common Defenses. (a) subsequent new value; (b) contemporaneous exchange of new value; and (c) ordinary course of business. *See*, [11 U.S.C. § 547\(c\)](#).
- c. Fraudulent transfers. [11 U.S.C. § 548](#) provides that a trustee or debtor-in-possession can avoid actual or constructively fraudulent transfers. Two year reach back. However, under [11 U.S.C. § 544](#), California's four year statute of limitations applicable.

- d. Post-petition transfers. [11 U.S.C. § 549](#) allows for avoidance of unauthorized post-petition transfers initiated by the debtor. Section 362 voids unauthorized post-petition transfers initiated by creditors.
 - e. Recovery of avoided transfers. [11 U.S.C. § 550](#) allows for recovery of an avoided transfer. Initial transferee strictly liable. Subsequent transferees liable unless they took in good faith, for value and without knowledge of avoidability of transfer.
3. Contested Matters. List of common types (non-exhaustive):
- a. Motions for relief from the automatic stay. [FRBP 4001\(a\)](#).
 - b. Motions for use of cash collateral. [FRBP 4001\(b\)](#).
 - c. Motions to obtain credit. [FRBP 4001\(c\)](#).
 - d. Avoidance of liens. [11 U.S.C. §522\(f\)](#).
 - e. Assumptions, rejection, or assignment of executor contracts. [11 U.S.C. § 365](#).
 - f. Appointment of a trustee or examiner. [FRBP 2007.1](#).
 - g. Dismissal or conversion of a case. [FRBP 1017\(f\)\(1\)](#).
 - h. Use, sale, or lease of real property. [FRBP 6004](#).
 - i. Objection to claim. [FRBP 3007](#).

X. ALTERNATIVES TO BANKRUPTCY

- A. Out of court workout—Informal
 - 1. Debtor – creditor negotiator
 - 2. Problem: Need full consensus
- B. Out of court workout—Formal
 - 1. Credit Managers Associate calls or meeting of creditors
- C. Assignment for Benefit of Creditors. [CCP § 1800 et seq.](#)
- D. Deeds in Lieu.