

CHAPTER 7

“Liquidation”

This booklet contains general information about chapter 7 of the United States Bankruptcy Code. Chapter 7 is the Bankruptcy Code’s “liquidation” chapter, which lawyers sometimes refer to as a “straight bankruptcy.” It is used primarily by individuals who wish to free themselves of debt simply and inexpensively, but may also be used by businesses that wish to liquidate and terminate their business. While information presented is accurate as of the date of publication, it should not be cited or relied upon as legal authority. It should not be used as a substitute for reference to the United States Bankruptcy Code (Title 11, United States Code) and the Federal Rules of Bankruptcy Procedure (Bankruptcy Rules), both of which may be reviewed at local law libraries, or to any local rules or practices adopted and disseminated by each bankruptcy court. Citations to the Bankruptcy Code and Rules are included in the text. Finally, this brochure should be a supplement to, not a substitute for, the advice of competent legal counsel.



UNITED STATES BANKRUPTCY COURT
Central District of California

January 2002

Alternatives

Debtors should be aware that there are several alternatives to chapter 7 relief. For example, debtors who are engaged in business, including corporations, partnerships, and sole proprietorships, may wish to remain in business and avoid liquidation. Such debtors should consider filing a petition under chapter 11 of the Bankruptcy Code. Under chapter 11, the debtor may seek an adjustment of debts, either by reducing the debt or by extending the time for repayment, or may seek a more comprehensive reorganization. Sole proprietorships may also be eligible for relief under chapter 13 of the Bankruptcy Code.

In addition, individual debtors who have regular income may seek an adjustment of debts under chapter 13 of the Bankruptcy Code. Indeed, the court may dismiss a chapter 7 case filed by an individual whose debts are primarily consumer rather than business debts if the court finds that the granting of relief would be substantial abuse of the provisions of chapter 7. 11 U.S.C. § 707(b). A number of courts have concluded that a chapter 7 case may be dismissed for substantial abuse when the debtor has the ability to propose and carry out a workable and meaningful chapter 13 plan. For more information, refer to the brochure entitled **CHAPTER 13: Adjustment of Debts of an Individual with Regular Income**.

Debtors should also be aware that out-of-court agreements with creditors or debt counseling services may provide an alternative to a bankruptcy filing.

Background

The potential chapter 7 debtor should understand that a straight bankruptcy case does not involve the filing of a plan of repayment as in chapter 13, but rather envisions the bankruptcy trustee's gathering and sale of the debtor's nonexempt assets, from which holders of claims (creditors) will receive distributions in accordance with the provisions of the Bankruptcy Code. Part of the debtor's property may be subject to liens and mortgages that pledge the property to other creditors. Under this chapter, the individual debtor is permitted to retain certain "exempt" property, while the debtor's remaining assets are liquidated by a trustee, with the money from the sale paid to creditors according to a statutory scheme of distribution. Accordingly, potential debtors should realize that the filing of a petition under chapter 7 may result in the loss of property.

Eligibility

In order to qualify for relief under chapter 7 of the Bankruptcy Code, the debtor must be an individual, partnership, or corporation. 11 U.S.C. §§ 109(b); 101(41). Relief is available under chapter 7 irrespective of the amount of the debtor's debts, or whether the debtor is solvent or insolvent. Id. An individual cannot file under chapter 7 or any other chapter, however, if during the preceding 180 days a prior bankruptcy petition was dismissed due to the debtor's willful failure to appear before the court or comply with orders of the court, or the debtor voluntarily dismissed the previous case after creditors sought relief from the bankruptcy court to recover property upon which they hold liens. 11 U.S.C. §§ 109(g); 362(d) and (e).

Purpose of Bankruptcy

One of the primary purposes of bankruptcy is discharging debts to give an honest individual debtor a "fresh start." The discharge has the effect of extinguishing the debtor's personal liability on dischargeable debts. In a chapter 7 case, however, a discharge is available to individual debtors only, not to partnerships or corporations. 11 U.S.C. § 727(a)(1). Although the filing of an individual chapter 7 petition usually results in a discharge of debts, an individual's right to a discharge is not absolute; and some types of debts are not discharged. A bankruptcy discharge does not extinguish a lien on property.

How Chapter 7 Works

A chapter 7 case begins with the debtor's filing a petition with the bankruptcy court.¹ The petition should be filed with the bankruptcy court serving the area where the individual lives or where the business debtor has its principal place of business or principal assets. 28 U.S.C. § 1408 (Central District of California Divisional Office locations are provided at the back of this brochure.) In addition to the petition, the debtor is also required to file with the court:

- Several schedules of assets and liabilities
- A schedule of current income and expenditures
- A statement of financial affairs
- A schedule of executory contracts and unexpired leases.

Bankruptcy Rule 1007(b).

A husband and wife may file a joint petition or individual petitions. 11 U.S.C. § 302(a). Unmarried partners or other family members cannot file a joint petition. Petition packages may be purchased at the Bankruptcy Court.

Information Necessary to Complete Forms

In order to complete the Official Bankruptcy Forms which make up the petition and schedules, the debtor will need to compile the following information:

- A list of all creditors and the amount and nature of their claims;
- The source, amount, and frequency of the debtor's income;
- A list of all of the debtor's property; and
- A detailed list of the debtor's monthly living expenses, i.e., food, clothing, shelter, utilities, taxes, transportation, medicine, etc.

(A list and order of necessary documents is provided at the end of this brochure.)

When a husband and wife file a joint petition, they should be sure to gather the above detailed data for both spouses.

Fees

Currently, the courts are required to charge a \$155 filing fee, a \$30 miscellaneous administrative fee, and a \$15 trustee fee. The administrative and trustee fees are assessed and collected at the time the case is filed. All fees should be paid to the clerk of the court upon filing or may, with the court's permission, be paid by individual debtors in up to four installments. 28 U.S.C. § 1930(a); Bankruptcy Rule 1006(b). The final installment shall be payable not later than 120 days after filing the petition. For cause shown, the court may extend the time of any installment, provided that the last installment is paid not later than 180 days after the filing of a petition. Bankruptcy Rule 1006(b). If a joint petition is filed, only one filing fee and one administrative and trustee fee are charged. Debtors should be aware that failure to pay these fees may result in dismissal of the case. 11 U.S.C. § 707(a).

Automatic Stay

The filing of a petition under chapter 7 “automatically stays” most actions against the debtor or the debtor’s property. 11 U.S.C. § 362. This stay arises by operation of law and requires no judicial action. As long as the stay is in effect, creditors generally cannot initiate or continue any lawsuits, wage garnishment, or even telephone calls demanding payments. Creditors normally receive notice of the filing of the petition from the clerk. Debtors may also give notice to creditors.

Exempt Property

One of the schedules of assets and liabilities which will be filed by the individual debtor is a schedule of “exempt” property. Federal bankruptcy law provides that an individual debtor² can protect some property from the claims of creditors either because it is exempt under federal bankruptcy law or because it is exempt under the laws of the debtor’s home state. 11 U.S.C. § 522(b). Many states have taken advantage of a provision in the bankruptcy law that permits each state to adopt its own exemption law, in place of the federal exemptions. In other jurisdictions, the individual debtor has the option of choosing between a federal package of exemptions or exemptions available under state law. Thus, whether certain property is exempt and may be kept by the debtor is often a question of state law. Legal counsel should be consulted to determine the law of the state in which the debtor lives.

Meeting of Creditors

A “meeting of creditors” is usually held 20 to 40 days after the petition is filed. If the United States trustee or bankruptcy administrator³ designates a place for the meeting that is not regularly staffed by the United States trustee or bankruptcy administrator, the meeting may be held no more than 60 days after the order for relief. Bankruptcy Rule 2003(a). The debtor must attend this meeting, at which creditors may appear and ask questions regarding the debtor’s financial affairs and property. 11 U.S.C. § 343. If a husband and wife have filed a joint petition, they both must attend the creditors’ meeting. The trustee also will attend this meeting and question the debtor on the same matters. It is important for the debtor to cooperate with the trustee and to provide any financial records or documents that the trustee requests. The trustee is required to examine the debtor orally at the meeting of creditors to ensure that the debtor is aware of the potential consequences of seeking a discharge in bankruptcy, including the effects on credit history, the ability to file a petition under a different chapter, the effect of receiving a discharge, and the effect of reaffirming a debt. In some courts, trustees may provide written information on these topics at or in advance of the meeting to ensure that the debtor is aware of this information. In order to preserve their independent judgment, bankruptcy judges are prohibited from attending the meeting of creditors. 11 U.S.C. § 341(c).

Conversion

In order to accord the debtor complete relief, the Bankruptcy Code allows the debtor to convert a chapter 7 case to either a chapter 11 reorganization case or a case under chapter 13,⁴ as long as the debtor meets the eligibility standard under the chapter to which the debtor seeks to convert, and the case has not previously been converted to chapter 7 from either chapter 11 or chapter 13. Thus, the debtor will not be permitted to convert the case repeatedly from one chapter to another. 11 U.S.C. § 706(a).

Distribution of Assets and the Role of the Case Trustee

Upon filing of the chapter 7 petition, an impartial case trustee is appointed by the United States trustee (in Alabama and North Carolina the court performs this function) to administer the case and liquidate the debtor's nonexempt assets. 11 U.S.C. § 701, 704. If, as is often the case, all of the debtor's assets are exempt or subject to valid liens, there will be no distribution to unsecured creditors. Typically, most chapter 7 cases involving individual debtors are "no asset" cases. If the case appears to be an "asset" case at the outset, however, unsecured creditors⁵ who have claims against the debtor must file their claims with the clerk of court within 90 days after the first date set for the meeting of creditors. Bankruptcy Rule 3002(c). In the typical no asset consumer chapter 7 case, there is no need for creditors to file proofs of claim. If the trustee later recovers assets for distribution to unsecured creditors, creditors will be given notice of that fact and additional time to file proofs of claim. Although secured creditors are not required to file proofs of claim in chapter 7 cases in order to preserve their security interests or liens, there may be circumstances when it is desirable to do so. A creditor in a chapter 7 case who has a lien on the debtor's property should consult an attorney for advice.

The commencement of a bankruptcy case creates an "estate." The estate technically becomes the temporary legal owner of all of the debtor's property. The estate consists of all legal or equitable interests of the debtor in property as of the commencement of the case, including property owned or held by another person if the debtor has an interest in the property. Generally speaking, the debtor's creditors are paid from nonexempt property of the estate.

The primary role of a chapter 7 trustee in an "asset" case is to liquidate the debtor's nonexempt assets in a way that maximizes the return to the debtor's unsecured creditors. The trustee will try to accomplish this in several different ways. First, the trustee will attempt to liquidate the debtor's nonexempt property. This includes both property that the debtor owns free and clear of liens and property which has market value above the amount of any security interest or lien and any exemption that the debtor holds in the property. The trustee pursues causes of action (lawsuits) belonging to the debtor and pursues the trustee's own causes of action to recover money or property under the trustee's "avoiding powers." The trustee's avoiding powers include the power to set aside preferential transfers made to creditors within 90 days before the petition, the power to undo security interests and other prepetition transfers of property that were not properly perfected under nonbankruptcy law at the time of the petition, and the

power to pursue nonbankruptcy claims such as fraudulent conveyance and bulk transfer remedies available under state law. In addition, if the debtor is a business, the bankruptcy court may authorize the trustee to operate the debtor's business for a limited period of time, if such operation will benefit the creditors of the estate and enhance the liquidation of the estate. 11 U.S.C. § 721. All of these activities of the trustee are designed to produce the maximum return for the debtor's unsecured creditors.

The distribution of the property of the estate is governed by section 726 of the Bankruptcy Code, which sets forth the order of payment of all claims. Under section 726, there are six classes of claims; and each class must be paid in full before the next lower class is paid anything. The debtor is not particularly interested in the trustee's disposition of the estate assets, except with respect to the payment of those debts which for some reason are not dischargeable in the bankruptcy case. The debtor's major interests in a chapter 7 case are in securing exempt property and in getting a discharge that covers as many debts as possible.

Discharge

A discharge releases the debtor from personal liability for discharged debts and prevents the creditors owed those debts from taking any action against the debtor or his property to collect the debts. The bankruptcy law regarding the scope of a chapter 7 discharge is complex, and debtors should consult competent legal counsel in this regard prior to filing. As a general rule, however, excluding cases which are dismissed or converted, individual debtors are discharged in more than 99 percent of chapter 7 cases. In most cases, unless a complaint has been filed objecting to the discharge or the debtor has filed a written waiver, the discharge will be granted to a chapter 7 debtor relatively early in the case, i.e., 60 to 90 days after the date first set for the meeting of creditors. Bankruptcy Rule 4004(c).

The grounds for denying an individual debtor a discharge in a chapter 7 case are very narrow and are construed against a creditor or trustee seeking to deny the debtor a chapter 7 discharge. Among the grounds for denying a discharge to a chapter 7 debtor are that the debtor failed to keep or produce adequate books or financial records; the debtor failed to explain satisfactorily any loss of assets; the debtor committed a bankruptcy crime such as perjury; the debtor failed to obey a lawful order of the bankruptcy court; or the debtor fraudulently transferred, concealed, or destroyed property that would have become property of the estate. 11 U.S.C. § 727; Bankruptcy Rule 4005.

In certain jurisdictions, secured creditors may retain some rights to seize pledged property, even after a discharge is granted. Depending on individual circumstances, a debtor wishing to keep possession of the pledged property, such as an automobile, may find it advantageous to "reaffirm" the debt. A reaffirmation is an agreement between the debtor and the creditor that the debtor will pay all or a portion of the money owed, even though the debtor has filed bankruptcy. In return, the creditor promises that as long as payments are made, the creditor will not repossess or take back the automobile or other property. Because there is a disagreement among the courts concerning whether a debtor, whose debt is not in

default, may retain the property and pay under the original contract terms without reaffirming the debt, legal counsel should be consulted to ensure that the debtor's rights are protected and that any reaffirmation is in the debtor's best interest.

If the debtor elects to reaffirm the debt, the reaffirmation should be accomplished prior to the granting of a discharge. A written agreement to reaffirm a debt must be filed with the court and, if the debtor is not represented by an attorney, must be approved by the judge. 11 U.S.C. § 524(c). The Bankruptcy Code requires that reaffirmation agreements contain an explicit statement advising the debtor that the agreement is not required by bankruptcy or non-bankruptcy law. In addition, the debtor's attorney is required to advise the debtor of the legal effect and consequences of such an agreement, including a default under such an agreement. The Code requires a reaffirmation hearing only if the debtor has not been represented by an attorney during the negotiating of the agreement. 11 U.S.C. § 524(d). The debtor may still repay any debt voluntarily, however, whether or not a reaffirmation agreement exists. 11 U.S.C. § 524(f).

Most claims against an individual chapter 7 debtor are discharged. A creditor whose unsecured claim is discharged may no longer initiate or continue any legal or other action against the debtor to collect the obligation. A discharge under chapter 7, however, does not discharge an individual debtor from certain specific types of debts listed in section 523 of the Bankruptcy Code. Among the types of debts which are not discharged in a chapter 7 case are alimony and child support obligations; certain taxes; debts for certain educational benefit overpayments or loans made or guaranteed by a governmental unit, debts for willful and malicious injury by the debtor to another entity or to the property of another entity, debts for death or personal injury caused by the debtor's operation of a motor vehicle while the debtor was intoxicated from alcohol or other substances, and debts for criminal restitution orders under title 18, United States Code. 11 U.S.C. § 523(a). To the extent that these types of debts are not fully paid in the chapter 7 case, the debtor is still responsible for them after the bankruptcy case has concluded. Debts for money or property obtained by false pretenses; debts for fraud or defalcation while acting in a fiduciary capacity; and debts for willful and malicious injury by the debtor to another entity or to the property of another entity, and debts arising from a property settlement agreement incurred during or in connection with a divorce or separation are discharged unless a creditor timely files and prevails in an action to have such debts declared excepted from the discharge. 11 U.S.C. § 523(c); Bankruptcy Rule 4007(c).

Finally, the court may revoke a chapter 7 discharge on the request of the trustee, a creditor, or the United States trustee if the discharge was obtained through fraud by the debtor, or if the debtor acquired property that is property of the estate and knowingly and fraudulently failed to report the acquisition of such property or to surrender the property to the trustee. 11 U.S.C. § 727(d).

References/Footnotes

¹ An involuntary chapter 7 case may be commenced under certain circumstances by the filing with the bankruptcy court of a petition by creditors holding claims against the debtor. 11 U.S.C. § 303.

² Each debtor in a joint case (both husband and wife) can claim exemptions under the federal bankruptcy laws. 11 U.S.C. § 522(m).

³ United States trustees and bankruptcy administrators are responsible for establishing a panel of private trustees to serve as trustees in chapter 7 cases, and supervising the administration of cases and trustees in cases under chapter 7, 11, 12 and 13 of the Bankruptcy Code. Bankruptcy administrators serve in the judicial districts in the state of Alabama and the state of North Carolina.

⁴ A fee of \$400 is charged for converting, on request of the debtor, a case under chapter 7 to a case under chapter 11. There is no fee for converting from chapter 7 to chapter 13.

⁵ Unsecured debts generally may be defined as those for which the extension of credit was based purely upon an evaluation by the creditor of the debtor's ability to pay, as opposed to secured debts, for which the extension of credit was based upon the creditor's right to seize pledged property on default, in addition to ability to pay.

List and Order of Required Documents - Chapter 7

- An original and four copies are required at the time of filing.
- Papers must be assembled into complete sets.
- Pursuant to Local Bankruptcy Rule 1002-1(g)(2), even if certain of the schedules or statement of Official Forms 6 and 7 are not applicable to a debtor's particular situation, they shall be filed with either the notation "None" marked thereon or the applicable box checked indicating that there is nothing to report for that particular schedule or statement.
- The first set must be the signed original.
- Pursuant to Local Bankruptcy Rule 1002-1, papers presented to the Court for filing or lodging should be on white paper, single-sided, pre-punched and backed. (The backing shall be flush at the top and extend no more than 1 inch below the bound pages and have the short title of the document typed in the lower right-hand corner. Example: Chapter 7 Petition.) Copies do not require backing.
 1. Voluntary Petition (first two pages)*
 2. Exhibit "C" to Voluntary Petition (if Exhibit "C" "yes" box is checked on page two of the Voluntary Petition)
 3. Corporate Resolution Authorizing Filing of the Petition (if debtor is a corporation)*
 4. Statement of Related Cases [required by Local Bankruptcy Rule 1015-2(b)(2)]*
 5. Notice of Available Chapters [required for individuals whose debts are primarily consumer debts (11 U.S.C. § 342(b)]*
 6. Summary of Schedules
 7. Schedules A through J (for corporations, A through H only)
 8. Declaration Concerning Debtor's Schedules (included with schedules)
 9. Statement of Financial Affairs

* Required at the time of emergency filing

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10. Chapter 7 Individual Debtor's Statement of Intention (11 U.S.C. § 521) [must be filed within 30 days from filing Petition (not required for corporations)]
 11. Disclosure of Compensation of Attorney for Debtor (for Petitions of persons who are represented by legal counsel or where an attorney has prepared the paperwork)
 12. Statement of Assistance of Non-Attorney with Respect to the Filing of This Petition (for persons not represented by counsel)*
 13. Disclosure of Compensation of Bankruptcy Petition Preparer (for persons not represented by counsel and where a bankruptcy petition preparer prepared the paperwork)
 14. Declaration Re Limited Scope of Appearance Pursuant to Local Bankruptcy Rule 2090-1 (if applicable)*
 15. Verification of Creditor Mailing List [Local Bankruptcy Rule 1007-2(d)]*
 16. Master Mailing List (in format required by Local Bankruptcy Rule 1007-2)*
 17. Computer Readable Diskette (required for Petition with over 100 creditors) [Local Bankruptcy Rule 1007-2(c)]

All Debtors filing a Petition on behalf of a corporation, partnership or unincorporated association **MUST** be represented by an Attorney [Local Bankruptcy Rule 2090-1(g)(1)].

* Required at the time of emergency filing

United States Bankruptcy Court
Central District of California
Office Locations

LOS ANGELES

Office of the Clerk
Edward R. Roybal Federal Building
and Courthouse
255 East Temple Street
Los Angeles, California 90012

Clerk's Office Operations
United States Federal Building
300 North Los Angeles Street
Los Angeles, California 90012

General Information (213) 894-3118

RIVERSIDE DIVISION

3420 Twelfth Street
Riverside, California 92501-3819

General Information (909) 774-1000

SANTA ANA DIVISION

411 West Fourth Street, Suite 2-030
Santa Ana, California 92701-4593

General Information (714) 338-5300

NORTHERN DIVISION

1415 State Street
Santa Barbara, California 93101

General Information (805) 884-4800

SAN FERNANDO VALLEY DIVISION

21041 Burbank Boulevard
Woodland Hills, California 91367

General Information (818) 587-2900

Bankruptcy Appellate Panel - Ninth Circuit

125 South Grand Avenue
Pasadena, California 91105