

community BANKER

NOVEMBER / DECEMBER 2017

Welcome to the latest issue of the COMMUNITY BANKER.

The Community Banker is prepared by attorneys at Olson & Burns P.C. to provide information pertaining to legal developments affecting the field of banking. In order to accomplish this objective, we welcome any comments our readers have regarding the content and format of this publication. Please address your comments to:

Community Banker
c/o Olson & Burns P.C.
P.O. Box 1180
Minot, ND 58702-1180

olsonpc@minotlaw.com
Also, visit our web site at:
www.minotlaw.com

The attorneys at Olson & Burns represent a wide range of clients in the financial and commercial areas. Our attorneys represent more than 30 banks throughout North Dakota.

BANKRUPTCY – AN OVERVIEW AND SOME BASIC TIPS

The previous issue of the *Community Bankers' Advisor* gave a synopsis of Chapter 12 bankruptcy, the chapter providing for the reorganization of family farmers. This issue will go back to the very beginning – a bankruptcy petition has landed on your desk, and you have many questions about what lies ahead.

TIP: There are four things to establish when you receive notice of the filing of a bankruptcy petition: (1) What type of case is it – 7, 11, 12 or 13? (2) Is my bank secured? (3) What is the value of my collateral? (4) Is my collateral at risk?

The goal of the bankruptcy laws is to give honest debtors a financial “fresh start” from burdensome debts, which is accomplished through the bankruptcy discharge. The discharge frees debtors from personal liability for specific debts and forbids creditors from ever taking any action against the debtor to collect those debts.



OLSON & BURNS P.C.

17 FIRST AVENUE S.E. • P.O. BOX 1180 • MINOT, NORTH DAKOTA 58702-1180
TELEPHONE (701) 839-1740 • FACSIMILE (701) 838-5315 • E-MAIL: olsonpc@minotlaw.com

II. THE DISCHARGE IN BANKRUPTCY

The bankruptcy discharge varies depending on the type of case a debtor files: chapter 7, 11, 12, or 13.

A. WHAT IS A DISCHARGE IN BANKRUPTCY?

A bankruptcy discharge releases the debtor from personal liability for certain specified types of debts; the debtor is no longer legally required to pay *any* debts that are discharged. The discharge is a permanent order prohibiting the creditors of the debtor from taking *any* form of collection action on discharged debts, including legal action and communications with the debtor, such as telephone calls, letters, and personal contacts.

However, all is not lost. Although a debtor is not personally liable for discharged debts, a valid lien that has not been avoided (made unenforceable) in the bankruptcy case will remain after the bankruptcy case. Therefore, a secured creditor *may enforce the lien* to recover the property secured by the lien.

TIP: Secured status is determined as of the date the case is filed - whether a creditor is secured, and if so, to what extent. If the value of the collateral does not exceed the debt whose repayment the collateral secures, then the claim will be split, and the creditor will have an allowed secured claim to the extent of the value of the collateral, and an allowed unsecured claim for the difference (sometimes referred to as the deficiency).

The lender's goal is to get paid, and this is accomplished by getting as much security as possible right when the loan is originated. Some suggestions:

- 1.0 Know your borrower. Distinguish between your borrower and related parties, and be clear on who owns what. Does John Smith own the tractor, or is it owned by Smith Brothers Partnership?
- 2.0 Take an assignment of rents with every non-residential mortgage.
- 3.0 Get personal guaranties of payment!
- 4.0 Don't forget the security agreement taking personal property collateral as well.
- 5.0 Get, and stay, oversecured.
- 6.0 If there is a bankruptcy filing and you are a secured creditor, consider a motion for relief from the automatic stay as soon as possible.

B. WHEN DOES THE DISCHARGE OCCUR?

The timing of the discharge varies, depending on the chapter under which the case is filed.

*In a chapter 7 (liquidation) case the court usually grants the discharge when the time set for filing a complaint objecting to discharge and the time set for filing a motion to dismiss the case for substantial abuse (60 days after the first date set for the first meeting of creditors or "341 meeting") has expired. Typically, this occurs about four months after the date the debtor files the petition.

*In individual chapter 11 cases (like a chapter 13), and in cases under chapter 12 (adjustment of debts of a family farmer or fisherman) and 13 (adjustment of debts of an individual with regular income), the court generally grants the discharge as soon as practicable after the debtor completes all payments under the plan.

*Since a chapter 12 or chapter 13 plan may provide for payments to be made over three to five years, the discharge typically occurs about four years after the date of filing. The court may deny an individual debtor's discharge in a chapter 7 or 13 case if the debtor fails to complete credit counseling from an approved agency. Every debtor must complete this course, with a few exceptions, such as if there are inadequate educational programs available, or if the debtor is disabled or incapacitated or on active military duty in a combat zone. If the debtor fails to timely complete this class and file the appropriate form with the court, the court will dismiss the case without a granting a discharge.

C. HOW DOES THE DEBTOR GET A DISCHARGE?

Unless there is litigation involving objections to the discharge, the debtor will usually automatically receive a discharge. The clerk of the bankruptcy court must mail a copy of the order of discharge to all creditors, the U.S. trustee, the trustee in the case, and the trustee's attorney, if any. The notice, which is simply a copy of the final order of discharge, is not specific as to those debts determined by the court to be non-dischargeable, *i.e.*, those debts *not* covered by the discharge and still collectible, such as your bank's mortgage.

The notice informs creditors generally that the debts owed to them have been discharged and that they should not attempt any further collection. They are cautioned in the notice that continuing collection efforts could subject them to punishment for contempt. Any inadvertent failure on the part of the clerk to send the debtor or any creditor a copy of the discharge order promptly within the time required by the rules does not affect the validity of the order granting the discharge.

D. ARE ALL OF THE DEBTOR'S DEBTS DISCHARGED OR ONLY SOME?

Not all debts are discharged, and that varies under each chapter of the Bankruptcy Code. Section 523(a) of the Bankruptcy Code specifically omits various categories of debts from the discharge granted to individual debtors, so the debtor must still repay those debts after bankruptcy. These types of debts are not dischargeable for public policy reasons (based either on the nature of the debt or the fact that the debts were incurred due to behavior of the debtor, such as the debtor's drunken driving).

There are 19 categories of debt omitted from discharge under chapters 7, 11, and 12. A more limited list of exceptions applies to cases under chapter 13. The most common types of nondischargeable debts, in no particular order, are (1) certain types of tax claims, (2) debts not included by the debtor on the lists and schedules the debtor must file with the court, (3) debts for spousal or child support or alimony, (4) debts for willful and malicious injuries to person or property (*i.e.* damages awarded against the debtor for attacking and injuring someone), (5) debts to governmental units for fines and penalties, (6) debts for most government funded or guaranteed student loans or benefit overpayments, (7) debts for personal injury caused by the debtor's operation of a motor vehicle while intoxicated, (8) debts owed to certain tax-advantaged retirement plans, and (9) debts for certain condominium or cooperative housing fees.

Types of obligations affected by fraud or maliciousness are *not* automatically omitted from discharge. Creditors must file a complaint in an adversary action asking the court to determine that these debts are omitted from discharge.

TIP: When your borrower files for bankruptcy, YOU, the lender, must carefully and thoroughly review the Debtor's Petition and all attachments. YOU know your customer better than your attorney does, and YOUR sharp eyes will be the means to find errors, discrepancies, and outright fraud.

A complaint to determine dischargeability might be considered if you really feel that lying, fraud, false financial statements, vandalism to, or conversion of, collateral or other unusual events has

occurred. Unfortunately, these actions are not easy to win, and require proof by the preponderance of the evidence that the debtor had actual intent to harm your interests through the use of a false financial statement or other improper actions.

Generally, if a timely complaint to determine dischargeability is not filed, then the debt *will be* subject to discharge.

A slightly broader discharge of debts is available to a debtor in a chapter 13 case than in a chapter 7. Debts dischargeable in a chapter 13 but not in chapter 7 include (1) debts for willful and malicious injury to property, (2) debts incurred to pay non-dischargeable tax obligations, and (3) debts arising from property settlements in divorce or separation proceedings. Although a chapter 13 debtor generally receives a discharge only after completing all payments required by the court-approved (*i.e.*, "confirmed") repayment plan, there are some limited circumstances under which the debtor may request the court to grant a "hardship discharge" even though the debtor has failed to complete plan payments. Such a discharge is available only to a debtor whose failure to complete plan payments is due to circumstances beyond the debtor's control. A hardship discharge also is available in chapter 12 if the failure to complete plan payments is due to "circumstances for which the debtor should not justly be held accountable."

E. DOES THE DEBTOR HAVE THE RIGHT TO A DISCHARGE OR CAN CREDITORS OBJECT TO THE DISCHARGE?

In chapter 7 cases, the debtor does not have an absolute right to a discharge. An objection to the debtor's discharge may be filed by a creditor, by the trustee in the case, or by the U.S. trustee. Creditors receive a notice shortly after the case is filed that sets forth much important information, including the deadline for objecting to the discharge. To object to the debtor's discharge, a creditor must file a complaint in the bankruptcy court before the deadline set out in the notice, which starts a lawsuit called an "adversary proceeding."

The court may deny a chapter 7 discharge for different reasons including (1) failure to provide requested tax documents; (2) failure to complete a course on personal financial management; (3) transfer or concealment of property with intent to hinder, delay, or defraud creditors; (4) destruction or concealment of books or records; (5) perjury and other fraudulent acts; (6) failure to account for the loss of assets; (7) violation of a court order or (8) an earlier discharge in an earlier case commenced within certain time frames (discussed below) before the date the petition was filed. If the issue of the debtor's right to a discharge goes to trial, the objecting party has the burden of proving all the facts essential to the objection.

In chapter 12 and chapter 13 cases, the debtor is usually entitled to a discharge upon completion of all payments under the plan. Discharge may not occur in chapter 13 if the debtor fails to complete a required course on personal financial management. A debtor is also ineligible for a discharge in chapter 13 if he or she received a prior discharge in another case commenced within time frames discussed in the next paragraph. Unlike chapter 7, creditors *do not have standing* to object to the discharge of a chapter 12 or chapter 13 debtor. Creditors can object to confirmation of the repayment plan, but cannot object to the discharge if the debtor has completed making plan payments.

F. CAN A DEBTOR RECEIVE A SECOND DISCHARGE IN A LATER CHAPTER 7 CASE?

The court will deny a discharge in a later chapter 7 case if the debtor received a discharge under chapter 7 or chapter 11 in a case filed within EIGHT years before the second petition is filed. The court will also deny a chapter 7 discharge if the debtor previously received a discharge in a chapter 12 or chapter 13 case filed within SIX years before the date of the filing of the second case unless (1) the debtor paid all "allowed unsecured" claims in the earlier case in full, or (2) the debtor made payments under the plan in the earlier case totaling at

least 70% of the allowed unsecured claims and the debtor's plan was proposed in good faith and the payments represented the debtor's best effort. A debtor is ineligible for discharge under chapter 13 if he or she received a prior discharge in a chapter 7, 11, or 12 case filed FOUR years before the current case or in a chapter 13 case filed TWO years before the current case.

G. CAN THE DISCHARGE BE REVOKED?

The court may revoke a discharge under certain circumstances. For example, a trustee, creditor, or the U.S. trustee may request that the court revoke the debtor's discharge in a chapter 7 case based on allegations that the debtor (1) obtained the discharge fraudulently; (2) failed to disclose the fact that he or she acquired or became entitled to acquire property that would constitute property of the bankruptcy estate; (3) committed one of several acts of impropriety described in section 727(a)(6) of the Code; or (4) failed to explain any misstatements discovered in an audit of the case or fails to provide documents or information requested in an audit of the case. Typically, a request to revoke the debtor's discharge must be filed within ONE YEAR of the discharge *or*, in some cases, before the date that the case is closed. The court will decide whether such allegations are true and, if so, whether to revoke the discharge. In chapter 11, 12, and 13 cases, if confirmation of a plan or the discharge is obtained through fraud, the court can revoke the order of confirmation or discharge.

H. MAY THE DEBTOR PAY A DISCHARGED DEBT AFTER THE BANKRUPTCY CASE HAS BEEN CONCLUDED?

A debtor who has received a discharge may *voluntarily* repay any discharged debt. After discharge, a debtor may decide to repay a discharged debt even though it can no longer be legally enforced and he's under no legal obligation to pay the debt. Sometimes a debtor agrees to repay a debt because it is owed to a family member or because a bill is owed to someone that the debtor wants to continue to see or do business with - such as a trusted dentist or accountant.

I. WHAT CAN THE DEBTOR DO IF A CREDITOR ATTEMPTS TO COLLECT A DISCHARGED DEBT AFTER THE CASE IS CONCLUDED?

If a creditor attempts collection efforts on a discharged debt, the debtor can file a motion with the court, reporting the action and asking that the case be reopened to address the matter. The bankruptcy court will often do so to ensure that the discharge is not violated. The discharge is a *permanent* injunction prohibiting creditors from taking any action designed to collect a discharged debt. Violating the discharge injunction may bring a creditor more headache and expense, such as an award of damages and attorneys' fees and/or a charge of civil contempt, typically punishable by a fine.

J. MAY AN EMPLOYER TERMINATE A DEBTOR'S EMPLOYMENT SOLELY BECAUSE THE PERSON WAS A DEBTOR OR FAILED TO PAY A DISCHARGED DEBT?

No. The law prohibits discriminatory treatment of debtors by both governmental units and private employers. A *private* employer such as a bank may not discriminate with respect to employment if the discrimination is based *solely* upon the bankruptcy filing.

DISCLAIMER

COMMUNITY BANKER is designed to share ideas and developments related to the field of banking. It is not intended

as legal advice and nothing in the COMMUNITY BANKER should be relied upon as legal advice in any particular matter. If legal advice or other expert assistance is needed, the services of competent, professional counsel should be sought.