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## **Bankruptcy 101: Tips from the Bench and Bar**

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## **Chapter 7 Fundamentals**

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The most common form relief sought by debtors under the Bankruptcy Code (“Code”) is Chapter 7. It governs the liquidation for struggling consumers and business entities seeking an opportunity to start anew—a “fresh start” in bankruptcy parlance.

### **Eligibility**

Chapter 7 is only available to debtors who meet the eligibility requirements under Section 109 of the Code. And unless an enumerated exception applies, a person (be they an individual or entity) that resides or has a domicile, a place of business or property in the United States is generally considered an eligible debtor under the Code.

There are also separate requirements affecting the eligibility of individual debtors. A debtor is barred from filing for bankruptcy unless he or she has undergone credit counseling, pursuant to Section 109(h). The “Means Test” is the second, and perhaps the largest, obstacle an individual debtor (with primarily consumer debts) faces in obtaining Chapter 7 relief. The idea is to foreclose Chapter 7 relief to debtors whose monthly income (reduced by various allowed deductions) exceeds the median family income and would otherwise be enough to repay a significant amount of debt under Chapter 13.

### **Voluntary Chapter 7**

Typically, a debtor will initiate the bankruptcy process by filing a voluntary petition with the clerk. This moment is important for two reasons: (1) it creates an “estate,” which comprises all legal or equitable interest the debtor has in property; and (2) it triggers an “automatic stay” enjoining creditors from taking any actions against the debtor or the bankruptcy estate for the duration of the bankruptcy. A trustee is simultaneously appointed to represent the interests of the estate and oversees the collection, liquidation and distribution of non-exempt assets—the

proceeds of which are distributed to creditors, according to their “priority” under the Code. A trustee is also empowered to avoid certain preferential transfers made prior to the commencement of the case.

### **Involuntary Chapter 7**

Though not as common as voluntary petitions, a debtor may also be forced into bankruptcy by unsecured creditors. The number of creditors needed to initiate an involuntary petition depends on whether the debtor has less than 12 holders of claims that are not contingent as to liability or subject to a bona fide dispute. If the debtor has 12 or more of these qualified claims, then three creditors, with claims in the aggregate of \$15,325, are required to commence an involuntary petition. However, a debtor with less than 12 of these claims may be haled into bankruptcy court by one creditor possessing a qualified claim in the amount of \$15,325. Involuntary cases are uncommon, likely because of the penalties for misfiling such actions. *See* 11 U.S.C.A. § 303(h).

### **Property of the Estate**

The concept of estate in Chapter 7 is broad and covered by Bankruptcy Code Section 541. Notably, an individual debtor’s post-petition earnings do not come into the estate. *See* § 541(a)(6). However, some assets received during the first 180 days of the bankruptcy case—insurance proceeds, inheritance, and the like—may be estate property and subject to distribution by the trustee. *See* § 541(a)(5).

### **Discharge**

Once debtors have successfully complied with the requirements under the Code, they are entitled to a discharge. Unlike an entity, which simply dissolves under non-bankruptcy law, an individual debtor is discharged from personal liability for most pre-bankruptcy debt. A

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