

## The Impact of Bankruptcy on Your Collection Practice

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You are attempting to collect a judgment for your client and your judgment-debtor files a bankruptcy petition. Now what? There are several steps you should take before and after a bankruptcy filing to protect your client's interests and to maximize their recovery.

### Before a Bankruptcy Petition Is Filed

Upon obtaining a state court judgment, docket the judgment with the lien and judgment section of the New Jersey State Court. NJ Court Rule 4:101. This makes the judgment a lien on the judgment-debtor's real property in New Jersey. A judgment from a federal court outside New Jersey or from another state is considered a "foreign judgment" that should be domesticated under New Jersey's Uniform Enforcement of Foreign Judgments Act, N.J.S.A. 2A:49A-25 et seq., prior to docketing.

Next, levy upon your judgment. The levying judgment-creditor gets a judgment lien with priority over all non-levying creditors on the asset(s) levied upon. A successful levy may protect you in a subsequent bankruptcy proceeding. Section 544 of the Bankruptcy Code, 11 U.S.C. §101 et seq., provides a bankruptcy trustee the ability to avoid a judgment lien by a judgment-creditor that has not levied. Practically speaking, in New Jersey this means that a judgment-creditor who simply docket a judgment may find themselves unsecured in the judgment-debtor's bankruptcy case. On the other hand, the judgment-creditor who actively pursues collection and has levied will find themselves in the best position when their judgment-debtor files a bankruptcy petition.

### When a Bankruptcy Petition Is Filed

A bankruptcy case is initiated by the filing of a petition. The majority of bankruptcy petitions are filed either under Chapter 7, 11 or 13 of the Bankruptcy Code. A Chapter 7 case is a liquidation case where a trustee is appointed to marshal and liquidate the debtor's assets for the benefit of creditors.

A Chapter 11 case is a business reorganization case utilized by businesses and high net worth individuals. The debtor, designated a debtor-in-possession (DIP), generally continues to operate the business during the bankruptcy case. The DIP proposes a reorganizing or liquidating plan to exit the bankruptcy case along with a disclosure statement which explains the plan in detail.

A Chapter 13 case is a reorganization case for individuals, sometimes called a “wage earner plan.” To be eligible for Chapter 13, the debtor must be an individual with regular income, and have unsecured debts and secured debts of less than certain limits set forth in the Bankruptcy Code. The debtor contributes a portion of their monthly income to a standing Chapter 13 trustee pursuant to a Chapter 13 plan, which is distributed to creditors.

Regardless of the chapter, the judgment-creditor’s attorney should take the following steps to maximize the client’s recovery:

1. *Calendar Deadlines*

This step is critical, as the court does not have the discretion to extend some of these deadlines. *You may be waiving substantive rights if you miss these deadlines.* Some deadlines will appear on the Notice of Case Commencement that all creditors should receive at the beginning of the case, and others will be apparent from a review of the court’s docket. The important dates include the deadline to file proofs of claim and to object to the debtor’s discharge, and the date of the meeting of creditors. Other dates may not be so obvious, and may require calculation and review of applicable provisions of the Bankruptcy Code and/or Rules.

2. *Review Important Pleadings*

All debtors must file Schedules of Assets and Liabilities and a Statement of Financial Affairs. The schedules contain a detailed listing of all of the debtor’s assets and liabilities. Real property is listed on Schedule A, along with an indication of the value of the property and existing liens. Personal property is listed on Schedule B. All of the debtor’s creditors are identified on the schedules and, for individual debtors, details regarding monthly income and expenses are listed. For individual debtors, property claimed as exempt is listed on Schedule C. Exemptions are legislative determinations that certain property of a debtor should be exempt from the claims of creditors.

The Schedules contain important information that may assist your collection efforts if the bankruptcy case is dismissed. Schedule B provides information on personal property, like bank accounts, that a creditor may levy upon if the case is dismissed. Also, in New Jersey, where a judgment-creditor must levy upon personal property before attempting a levy on real property, schedule B should provide an accurate list of all the debtor’s personal property.

The Statement of Financial Affairs contains a variety of questions that provide creditors with significant insight into the debtor’s assets and liabilities, as well as potential issues that could come up in the case. For example, the debtor is required to identify all pending lawsuits that it was involved in when the case was filed.

3. *Review and Stop Collection Activities*

Section 362 of the Code imposes an automatic stay on all collection activities against a debtor once a bankruptcy case has been filed. The purpose of the automatic stay is to allow

the debtor a breathing spell so that assets may be marshalled and distributed equally to creditors.

Upon learning of a bankruptcy filing, a creditor should stop collection efforts. Lawsuits should be stayed and pending sheriff's sales adjourned. The failure to stop collection efforts may result in a lawsuit filed against the creditor seeking damages for violating the automatic stay. Even seemingly innocuous collection efforts, such as mailing a monthly statement indicating an amount presently due, may violate the stay. Section 362(k) permits an individual injured by a willful violation of the automatic stay to recover actual damages, costs and attorney fees, and even punitive damages in some circumstances.

There are certain exceptions to the stay listed in section 362(b). The automatic stay may also be limited for repeat filers. If the debtor has previously filed one or more bankruptcy petitions, then the creditor should consult an experienced bankruptcy attorney to discuss the applicability of the automatic stay.

In some circumstances, judgment-creditors who have perfected a levy prior to the filing may seek relief from the automatic stay to continue collection activities. Such creditors may be entitled to stay relief if the debtor does not have any equity in the property and the property is not necessary for an effective reorganization.

The automatic stay generally does not stay collection efforts against non-debtors liable with the debtor on a creditor's claim, such as non-debtor guarantors. Nonetheless, the judge in a pending action may administratively stay the action if one defendant files a bankruptcy petition. A special case occurs in Chapter 13 where section 1301 provides a unique "co-debtor stay." Under that section, a stay goes into effect which prohibits collection efforts against a non-debtor individual who is liable with the debtor, unless certain exceptions apply.

#### 4. *File a Notice of Appearance*

This document notifies parties in interest that you represent the creditor. The attorney filing a notice of appearance will receive electronic notifications of all filings in the case, and so will be able to promptly take action to protect their client.

#### 5. *Decide Whether to Attend the Creditors Meeting*

All bankruptcy cases include a meeting of creditors pursuant to section 341 of the Bankruptcy Code. Attorneys attending the meeting may be permitted to ask the debtor a limited number of questions. If a creditor wishes to undertake a more extensive questioning of the debtor, a formal examination under Bankruptcy Rule 2004 is the more appropriate tool. Creditors attending the meeting should advise the trustee conducting the meeting of any anomalies in the debtor's filings.

#### 6. *File a Proof of Claim or a Request for Administrative Expenses*

In many cases, a creditor must file a proof of claim to participate in any distribution from the bankruptcy estate. The Notice of Case Commencement will list the proof of claim bar

date, or will advise creditors that claims should not be filed unless notified by the court. With some exceptions, claims are submitted using Official Bankruptcy Forms. There are some circumstances where a proof of claim is not required, such as a no-asset Chapter 7 case, or in Chapter 11 cases where the creditor's claim is correctly listed and is undisputed on the debtor's schedules. The best practice is to always file a proof of claim unless directed not to by the court.

An administrative expense is a special type of claim generally incurred after the bankruptcy filing that is given priority, and may sometimes be paid during the pendency of the case. A non-exclusive list of types of administrative expense claims is set forth in Section 503(b) of the Bankruptcy Code. You should consult an experienced bankruptcy counsel if you believe you may be entitled to an administrative expense claim.

#### *7. Decide Whether to Conduct Discovery*

Bankruptcy Rule 2004 allows any party involved in a bankruptcy case to take the examination of the debtor or any other entity. The scope of the examination is broad. The 2004 examination may be useful if you have had trouble getting a judgment-debtor to appear for a post-judgment deposition.

#### *8. Consider Whether Your Claim May Be Non-Dischargeable*

The bankruptcy discharge releases the debtor from personal liability for certain debts. The debtor is no longer legally required to pay debts that are discharged. The discharge prohibits creditors from taking any form of collection action on discharged debts, including legal action and communications with the debtor.

In some circumstances, the debtor may be denied a discharge. Section 727(a) of the Code lists some of these circumstances, including, the removal or concealment of assets, the destruction or concealment of documents related to the debtor's financial condition, and the failure to explain any loss of assets. If a debtor is denied a discharge under section 727, all creditors will be able to pursue their claims against the debtor after the bankruptcy case is closed.

Section 523 permits an individual creditor to challenge the discharge of their particular debt. A debt qualified under section 523 is enforceable after the bankruptcy is closed. Some obligations, such as domestic support obligations and student loans, are presumed non-dischargeable. Other debts may be deemed non-dischargeable by court order. These include certain debts incurred by fraud and debts relating to willful and malicious injuries. If a creditor's claim was not reduced to judgment pre-petition, the creditor may seek to have the bankruptcy court liquidate its claim by entering a money judgment in connection with a section 523 action.

#### *9. Consider Whether There is a Basis to Dismiss the Case*

Sections 1112 and 1307 provide for dismissal of Chapter 11 and Chapter 13 cases, respectively, for cause. These sections contain non-exclusive lists of circumstances that

may provide cause for dismissal, such as gross mismanagement of the bankruptcy estate. A case may also be dismissed for failure to comply with other sections of the Bankruptcy Code. For example, a Chapter 13 case may be dismissed if the debts exceed certain limitations. A creditor who believes cause exists should file a motion to dismiss the case.

## **Creditor Beware: Preferences**

Finally, a judgment-creditor must always beware of a preference claim. Section 547 permits the “claw back” of certain transfers made to creditors within 90 days of the bankruptcy filing (or one year for insiders) as “preferences.” This section may require a creditor who received payments pre-petition to repay some of the money and may also be used to avoid a judgment lien acquired within 90 days of the filing. There are several defenses available to such an action. A creditor unfamiliar with these types of actions should consult experienced bankruptcy counsel.

In summary, in the collection arena, the law favors the diligent creditor. By following the steps above, the judgment-creditor’s attorney can maximize the recovery for their client before and after a bankruptcy filing.

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