Naval Legal Service Office Pacific
Legal Assistance Division
PSC 473 Box 14
FPO AP 96349-2400

Yokosuka, Japan
DSN 243-5141
Off-base: 046-816-5141
Facsimile: DSN 243-5829

Preventative Law Series

Bankruptcy

Bankruptcy allows a debtor, who is unable or unwilling to pay his or her creditors, to resolve debts through the liquidation and division of assets among creditors or in some cases through the repayment of the debt at a reduced rate over a specified period of time. The traditional relationships between a borrower/debtor and their lenders/creditors usually treated by state law are, however, controlled by federal bankruptcy law when this/these relationship(s) fail(s). The purpose of bankruptcy is to relieve the debtor of the burden of his or her financial obligations while treating the creditors with some measure of equality. Whereas state collections and debtor-creditor laws emphasize a race by individual creditors to act, federal bankruptcy law emphasizes the equal treatment of those within a general class of creditors (and there do exist different classes of creditors).

Bankruptcy law is federal statutory law contained in Title 11 of the United States Code as revised in 2005. Congress passed the Bankruptcy Code under its Constitutional grant of authority to "establish. . . uniform laws on the subject of Bankruptcy throughout the United States." States may not regulate bankruptcy though they may pass laws that govern other aspects of the debtor-creditor relationship, such as what property is exempt from bankruptcy actions. The availability of a particular state's exemptions within the recent revision now requires a two-year residency requirement in advance of the filing, or the exemptions revert to the prior state in which the resident resided for the six months prior to the two years.

Bankruptcy proceedings are supervised by and litigated in the United States Bankruptcy Courts. These courts are a part of the District Courts of The United States. The United States Trustees were established by Congress to handle many of the supervisory and administrative duties of bankruptcy proceedings. Proceedings in bankruptcy courts are governed by the Bankruptcy Rules, which were promulgated by the Supreme Court under the authority of Congress. The Bankruptcy statute is referred to as the Bankruptcy Code.

There are two basic types of Bankruptcy proceedings.

1) A filing under Chapter 7 is called liquidation. It is the most common type of bankruptcy proceeding. Liquidation involves the appointment of a trustee who collects the non-exempt property of the debtor, sells it and distributes the proceeds to the creditors.

2) Bankruptcy proceedings under Chapters 11, 12, and 13 involves the rehabilitation of the debtor to allow him or her to use future earnings to pay off creditors.

Under Chapter 7, 12, 13, and some 11 proceedings, a trustee is appointed to supervise the assets of the debtor. A bankruptcy proceeding may be entered into either voluntarily by a debtor or initiated by creditors. After a bankruptcy proceeding is filed, creditors, for the most part, may not seek to collect their debts outside of the proceeding. Usually after the filing for bankruptcy protection, collection actions are stayed and such stays are often automatic. The length of and means for terminating the stay may vary depending on the type of bankruptcy and whether the debtor has recent history of having previously filed. The debtor is not allowed to transfer property that has been declared part of the estate subject to proceedings. Furthermore, certain pre-proceeding transfers of property, secured interests, and liens may be delayed or invalidated. Various provisions of the Bankruptcy Code also establish the priority of creditors' interests.

The 2005 Revision exempts retirement IRAs and limits to some extent state homestead exemptions. As of October 17, 2005, credit counseling from a government approved organization within six months before the filing for bankruptcy is required. The U.S. Trustee Program keeps the list of government-approved credit counseling organizations which can be found at www.usdoj.gov/ust. This counseling has been waived temporarily for filers in Louisiana and the Southern District of Mississippi due to Hurricane Katrina. The Federal Trade commission offers information and suggestions on the requirements of and pointers in choosing a credit counselor at their websites www.ftc.gov/bcp/conline/pubs/alerts/banklawalrt.htm and www.ftc.gov/bcp/alerts/banklawalrt.pdf.