Holding Traffickers to Account in Bankruptcy Proceedings:

A Guide for Advocates Representing Trafficking Survivors

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Introduction

Trafficking survivors may encounter bankruptcy in a myriad of ways: a survivor may find their civil trafficking case stayed in the face of a bankruptcy filing by a trafficker-defendant. A trafficking survivor may face challenges collecting a civil judgment against a defendant who files for bankruptcy. In addition, enforcement of a criminal restitution order after a conviction in a federal case may stall after a trafficker's bankruptcy filing.

Since 2003, the first year that civil trafficking cases became possible under federal law, trafficking survivors have filed more than 500 cases, resulting in more than $255 million in public settlements and judgments.[1] Federal courts have ordered traffickers to pay millions of dollars in criminal restitution to their victims.[2] In some of these cases, traffickers have turned to the bankruptcy courts to thwart collections and accountability. In some instances, those bankruptcy filings are fraudulent, an effort to hide assets and prevent enforcement of civil, governmental, or administrative actions. In other cases, the bankruptcy filings are valid, but may not preclude a trafficking survivor's financial recovery.

In either circumstance, a bankruptcy filing has profound implications for trafficking survivors and their counsel. Victims' rights attorneys and civil litigators representing trafficking survivors must have a familiarity with bankruptcy law in order to protect the rights of these clients.[3]

The purpose of this guide is to assist counsel representing survivors of human trafficking in protecting their clients' rights in the event of a bankruptcy filing by a trafficker. A summary of key bankruptcy concepts, including the bankruptcy chapters that may be implicated by a trafficker's filing, can be found in Addendum A. The filing of a bankruptcy case by a trafficker can significantly affect survivors' rights, including their ability to collect on a judgment.[4] This guide focuses on some of the key issues that counsel may want to consider when a trafficker-debtor files for bankruptcy, including:

- **Commencement of Bankruptcy Case and Receiving Notices From the Court**
- **Halting Collection Activity and Considering the Effect of the Automatic Stay on Litigation**
- **Seeking the Assistance of the Case Trustee and the U.S. Trustee**
- **Seeking Discovery About the Debtor**

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[1] Rebekah R. Carey, Federal Human Trafficking Civil Litigation: 2020 Data Update, The Human Trafficking Legal Center (July 2021).

[2] Federal criminal restitution is mandatory in human trafficking cases. 18 U.S.C. §1593.

[3] In some instances, it may be possible to connect trafficking survivors with pro bono counsel to advise on issues raised by a defendant's bankruptcy filing. For more information on obtaining a referral, please contact The Human Trafficking Legal Center at info@htlegalcenter.org.

[4] Trafficking survivors themselves often face financial challenges and may also file for bankruptcy as debtors. That situation is beyond the scope of this guide, but the National Conference of Bankruptcy Judges and several district bankruptcy courts have compiled information and guidance for those interested in filing for personal bankruptcy protections. Trafficking survivors should consider contacting their local pro bono offices or the resources identified by the National Conference of Bankruptcy Judges for additional resources and potential representation. *See* e.g., https://www.ncbj.org/page/OutreachProSeProBono;

https://www.mab.uscourts.gov/file/258;

https://www.nyeb.uscourts.gov/filing-pro-se-without-attorney

- **Evaluating the Relief to Which Your Client Might Be Entitled in Bankruptcy and Deciding Whether to File a Proof of Claim**
- **Filing a Proof of Claim (if Warranted)**
- **Evaluating the Impact of a Discharge**
- **Other Miscellaneous Considerations**

This list is not sequential or in any order of importance, and counsel will want to carefully consider the facts and circumstances of the client's case in determining which issues to prioritize when a trafficker commences a bankruptcy proceeding. Each issue is addressed in turn below.[5]

SECTION 1. Commencement of a Bankruptcy Case and Receiving Notices From the Court

When a trafficker commences a bankruptcy case as a debtor, they begin by filing a petition with the U.S. Bankruptcy Court. Shortly thereafter, a debtor is required to file numerous disclosures, including: (a) schedules of assets and liabilities, (b) a list of creditors, (c) a schedule of current income and expenditures, and (d) a statement of financial affairs under oath. This includes disclosure of the following:

- all real, personal, and intangible property, and exemptions claimed,
- all secured creditors and amounts owed,
- all unsecured creditors and amounts owed,
- executory contracts and leases,
- income and monthly expenses, and
- other co-obligors on any debts.

The statement of financial affairs provides additional information about the debtor's financial activities over specified time periods (often two years), including income or revenue, legal actions or claims, transfers of property before filing, gifts, losses, closed accounts, safety deposit boxes, and storage units. These documents provide a detailed picture of the debtor's income, assets, and obligations.

Upon learning of a bankruptcy case, you and your client should review the schedules, pleadings, notices, and other relevant filings in the case in order to ensure that your client's rights are protected and to determine what action, if any, needs to be taken.

What if your client is not listed as a creditor in the debtor's schedules or service list?

If the debtor fails to list your client on their schedules or master service list, your client may not receive notice of the bankruptcy proceeding or any bankruptcy filings. In this scenario, once your client becomes aware of the bankruptcy proceeding, you can take steps to protect their interests by filing a Notice of Appearance and Request for Notices. Filings are generally electronic but may be by paper in some jurisdictions, and it is always advisable to consult the local rules of the particular jurisdiction. This Notice and Request will instruct the debtor and other parties in interest to serve copies of relevant documents on you and your client. Once

[5] For further background, you will find some basic introductory bankruptcy concepts at Addendum A.

you have entered your appearance, you will receive notice of filings in the bankruptcy case via electronic notice through the Bankruptcy Court's PACER system.

If a debtor fails to schedule or list your client as a creditor, your client can file a proof of claim to protect their right to payment from the debtor. If your client did not have notice of the bankruptcy in time to file a proof of claim before passage of the claims "bar date," your client may be able to file an untimely claim based on lack of notice. Additionally, under certain circumstances, your client can ask the Bankruptcy Court to exclude the amount owed to your client from the debtor's discharge due to lack of notice. This is sometimes known as "excepting the debt." In considering a request to except a debt from discharge, a concept discussed later in this paper, the Bankruptcy Court will review factors, including the nature of the creditor's claim, the conduct of the debtor, and whether your client, the trafficking survivor, had actual notice of the bankruptcy.

Cases of Note: In *Lama v. Malik*, 58 F. Supp. 3d 226 (E.D.N.Y. 2014), the Court denied the defendant's motion to dismiss the plaintiff-survivor's claims as having been discharged in the defendant's prior bankruptcy after finding that the plaintiff's claims were not listed on the schedules created and filed by the defendant-debtor and the plaintiff-survivor had no notice of the bankruptcy proceeding.

SECTION 2. Halting Collection Activity and Considering the Effect of the Automatic Stay on Litigation

Once a bankruptcy case is commenced, the automatic stay immediately goes into effect. The automatic stay is an injunction that stops all lawsuits, foreclosures, garnishment actions, and collection activity against the debtor and the debtor's property. Violating the automatic stay is a serious offense and can subject the offender to sanctions or liability to the debtor for damages.

What is the effect of the automatic stay if your client has an active lawsuit or other proceeding against the debtor (outside of bankruptcy)?

If your client has a lawsuit pending against the debtor when the bankruptcy case is filed, the lawsuit will be stayed and no further action can be taken, unless your client (a) obtains an order from the Bankruptcy Court allowing your client to continue the litigation outside of bankruptcy or (b) has the lawsuit removed to Bankruptcy Court (if authorized). Which of these options is best suited to your client will depend upon the jurisdiction, the types of claims, and the status of the litigation. Sometimes, the Bankruptcy Court is a better venue to resolve commercial disputes, as bankruptcy judges are often more conversant with financial issues and often adjudicate claims in less time than many state courts.

Generally, the automatic stay does not apply to criminal cases or to certain family law, governmental investigatory, or regulatory proceedings. *See* 11 U.S.C. § 362(b). This includes certain (but not all) efforts to recover amounts owed for restitution.

Cases of Note: In *In re Frehoo*, No. 16-34137 (Bankr. D. Or. Nov. 8, 2016), the Bankruptcy Court for the District of Oregon granted leave to both the Bureau of Labor and Industries and civil litigants to proceed with litigation arising out of improper employment actions. In *EEOC v. Tim Shepard, M.D., P.A. d/b/a/ Shepard's Healthcare*, No. 17-CV-02569 (N.D. Tex. Oct. 11, 2018), the U.S. District Court for the Northern District of Texas held that an EEOC enforcement action could proceed against a Chapter 7 debtor where the EEOC was seeking a permanent injunction and the purpose of the action was to protect the public interest. *See also Partida v. United States DOJ*, 862 F.3d 909, 911 (9th Cir. 2017) (Mandatory Victims Restitution Act

overrides the automatic stay and permits government to offset payments of income to collect for criminal restitution debt owed); *EEOC v. Rath Packing Co.*, 787 F.2d 318 (8th Cir. 1986).

What is the effect of the automatic stay if your client has not yet filed a lawsuit against the debtor or is in the process of obtaining a judgment against the debtor in a pending civil lawsuit?

If your client wishes to initiate new litigation during the pendency of the debtor's bankruptcy case, they can file a complaint in the bankruptcy case. This filing will commence what is known as an adversary proceeding, which is a civil action that proceeds in the Bankruptcy Court. The Bankruptcy Court will hear and determine the disputes at issue, so long as the causes of action fall within the jurisdiction of the Bankruptcy Court, which can be limited in some circumstances. *See* 28 U.S.C. § 1334. Alternatively, your client can seek relief from the automatic stay in order to initiate or continue pending litigation in a nonbankruptcy forum. You should consider, however, whether simply filing a proof of claim asserting contingent and/or unliquidated damages and litigating the matter through a claims objection process is a more efficient way to assert your client's claims in the case, rather than commencing an adversary proceeding with the Bankruptcy Court.

What is the effect of the automatic stay if your client has already obtained a civil judgment on a pre-petition basis? Can your client perfect their lien (e.g., by recording a judgment) once the automatic stay is in effect?

The legal effect of a civil judgment, and how and when it becomes a lien on property, generally depends upon applicable nonbankruptcy law, which is usually, but not always, the state law where the property is located. However, if a creditor obtains a judgment prior to the bankruptcy filing, it generally cannot take additional steps to perfect[6] the lien once the automatic stay is in effect. Section 362(b) of the Bankruptcy Code provides a limited exception to this general rule where the creditor acquired rights in the property before the date of perfection. The court having rendered the judgment may proceed to docket it unilaterally even after a bankruptcy filing.

What is the effect of the automatic stay if your client is entitled to restitution from a pre-petition criminal proceeding or order?

A criminal prosecution or government enforcement action may call for restitution to be paid to a survivor or a group of survivors. Generally, the government, not the survivor, has the ability to record judgment liens and enforce the restitution order. Because the automatic stay does not generally apply to criminal enforcement actions, the government can take steps to enforce the restitution order. For example, the automatic stay does not extend to the seizure of retirement accounts to enforce a restitution order, other measures to enforce a restitution order, or revocation of probation during bankruptcy for failure to pay criminal restitution. *See Partida v. United States*, 531 B.R. 811 (9th Cir. B.A.P. 2015), *aff'd* 862 F.3d 909, 911 (9th Cir. 2017) (seizure of retirement accounts under Mandatory Victim Restitution Act); *United States v. Robinson*, 764 F.3d 554 (6th Cir. 2014) (government may enforce the enforcement order against assets included in the bankruptcy estate); *United States v. Colasuonno*, 697 F.3d 164 (2d Cir. 2012) (debtor's probation revoked after debtor filed for bankruptcy and failed to continue making restitution payments.). However, in *In re Reasonover*, 236 B.R. 219 (Bankr. E.D. Va. 1999), a Bankruptcy Court found that the government could not record a criminal restitution lien after the filing of a bankruptcy petition. If your client is

[6] To perfect a lien means that the creditor has taken the necessary steps—often filing paperwork with the appropriate filing agent—to make the security interest binding on third parties. Perfection provides legal notice to the world that the creditor has the right to seize the property in place of payments that are owed.

entitled to payment under a restitution order, you should discuss the matter with the governmental body responsible for enforcement of the order. In federal human trafficking cases, it is best practice to discuss restitution collection with the prosecuting Assistant U.S. Attorney, as well as the Financial Litigation Unit of the U.S. Attorney's Office in that jurisdiction. In cases where the federal authorities have obtained a forfeiture of the defendants' assets, contact the Money Laundering and Asset Recovery Section (MLARS) at the Department of Justice.[7] In such case, it may be possible to obtain the forfeited assets through a petition for restoration or remission.[8]

Where a restitution order has issued and a bankruptcy petition has not yet been filed, a survivor can seek an Abstract of Judgment, which is akin to a civil judgment. If a survivor receives an Abstract of Judgment, the survivor can seek to enforce restitution based on the Abstract. However, once a bankruptcy proceeding is filed, the automatic stay applies to all actions related to the survivor's attempt to collect under the Abstract of Judgment.

SECTION 3. Seeking the Assistance of the Case Trustee and the U.S. Trustee

Case trustees and U.S. Trustees can serve as a good resource about local bankruptcy practice and procedure and may be able to advise you about some of the options available to your client.

What is the role of the case trustee?

Once a bankruptcy petition is filed, the Bankruptcy Court automatically appoints a case trustee in Chapter 7 and 13 proceedings.

- In a Chapter 7 proceeding, the case trustee will review the information filed by the debtor, identify and take control of any nonexempt assets, and oversee the liquidation of nonexempt assets and payments to creditors.
- In a Chapter 13 proceeding, the case trustee will review the information filed by the debtor, assess the proposed plan and object to it if appropriate, oversee the debtor's plan to repay all or certain debtors over time, collect payments and distribute funds to creditors, and take other steps to carry out the terms of the confirmed plan.
- In most Chapter 11 proceedings, appointment of a case trustee is not the norm, and typically involves extraordinary circumstances. The debtor often remains in possession of the business during the course of the bankruptcy. However, trustees are the norm in one category of Chapter 11 cases, known as Subchapter V cases, which are smaller than many other Chapter 11 cases and involve small businesses. The trustees in Subchapter V cases generally play a more limited role than in Chapter 7 and Chapter 13 proceedings.

[7] The Human Trafficking Legal Center can provide technical assistance on collection of restitution and return of forfeited assets to trafficking victim-witnesses through restoration and remission. For more information, please contact the Human Trafficking Legal Center at info@htlegalcenter.org.

[8] Department of Justice, Returning Forfeited Assets to Crime Victims: An Overview of Remission and Restoration, https://www.justice.gov/sites/default/files/criminal-afmls/legacy/2011/05/12/victms-faqs.pdf

Can a case trustee assist in examining the financial statements of the debtor for clarification?

Chapter 7 and Chapter 13 trustees evaluate and make recommendations in accordance with the Bankruptcy Code, and conduct meetings of creditors known as 341 meetings. The primary role of a case trustee is to oversee the bankruptcy estate and ensure that the estate is managed and/or distributed in an appropriate manner.

Although the specific obligations of a case trustee differ based on the type of bankruptcy proceeding, trustees in Chapter 7 and Chapter 13 cases will always undertake a review of the debtor's assets and liabilities. Trustees will also review and potentially challenge creditors' claims. Trustees can use their role to ask questions, request information from the debtor or creditors, and uncover fraud or deception. If there are questions regarding a debtor's identification of assets or liabilities, or claims made by certain creditors, an interested party or creditor can request help from the case trustee and ask the case trustee to use their tools to investigate the issue.

Practice Pointer: When a corporate entity files for bankruptcy protection, the attorney-client privilege becomes part of the bankruptcy estate and the case trustee may have a right to control, and even waive, the attorney-client privilege in certain circumstances, such as where waiving the privilege would benefit the estate. Moreover, note that there can also be limits on the invocation of privilege by an individual debtor as well—for example, if the privilege relates to the debtor's conduct as a debtor in possession, or if the information was provided by the debtor to counsel for the purpose of transmitting it to the court. *See e.g., Commodity Futures Trading Commission v. Weintraub,* 471 U.S. 343 (1985); *Ramette v. Bame (In re Bame)*, 251 B.R. 367 (Bankr. D. Minn. 2000).

What is the role of the U.S. Trustee?

U.S. Trustees[9] are U.S. Department of Justice officials and part of the United States Trustee Program, a component of the Department of Justice. Their purpose is to protect the integrity of the bankruptcy system and they have authority to monitor bankruptcy cases for compliance with the Bankruptcy Code and to prevent undue delay. 28 U.S.C. § 586, 11 U.S.C. § 307. The United States Trustee Program also has authority to supervise case trustees, and review filings and plans. The United States Trustee Program can also take action to investigate bankruptcy fraud, seek civil penalties or other remedies against debtors or creditors, and refer cases of potential criminal conduct to the Office of the United States Attorney for investigation and potential criminal prosecution.

What if you believe that the debtor's bankruptcy petition was filed in bad faith? What role can the United States Trustee Program and/or the case trustee play?

In voluntary bankruptcy cases filed under Chapter 7 of the Bankruptcy Code, the Bankruptcy Court, after notice and hearing, and on a motion by the victim of a "crime of violence" (as defined in 18 U.S.C. § 16) or a "drug trafficking crime" (as defined in 18 U.S.C. § 924(c)(2)), may dismiss the case of a debtor convicted of such a crime if the Bankruptcy Court finds that dismissal is in the best interest of the victim. 11 U.S.C. § 707(c)(2). The Bankruptcy Court is not required to dismiss the case, however, and Section 707(c)(3) creates

[9] The U.S. Trustees system is in place in all jurisdictions except for Alabama and North Carolina, which operate under the Bankruptcy Administrator system. Bankruptcy Administrators have roles similar to U.S. Trustees.

an exception to dismissal if the debtor shows that the Chapter 7 case is necessary to satisfy a claim for a domestic support obligation. 11 U.S.C. § 707(c)(3).

Practice Pointer: It should be noted that dismissals under Section 707(c)(2) are somewhat infrequent, possibly because it may be in the victim's best interest for the bankruptcy case to proceed to discharge. 6 Collier on Bankruptcy ¶ 707.06 (16th ed. 2021). With a discharge, the debtor will be able to rid itself of other dischargeable debts, potentially leaving the debtor with a greater ability to satisfy its nondischargeable debts (including any nondischargeable debts owed to the survivor(s)).

Additionally, a Bankruptcy Court may dismiss any bankruptcy case on the grounds of bad faith—specifically, where there has been an abuse of the bankruptcy process or conduct that is incompatible with the functioning of the bankruptcy system. If there is evidence that the debtor's bankruptcy petition was filed in bad faith, your client can file a motion seeking to dismiss the bankruptcy. Note that proof of "bad faith" does not necessarily require proof of subjective evil intent. For example, courts have sometimes found "bad faith" based solely on the finding that the debtor could afford to pay his or her debts.

Whether or not a case was filed in bad faith will depend on a review of the circumstances leading up to the filing of the bankruptcy case, as well as the debtor's conduct within the bankruptcy case. General allegations of bad faith or intent to defraud are generally insufficient to support a motion to dismiss.

The case law on dismissals for bad faith can differ greatly among jurisdictions. Case examples include:

- *In re Linehan*, 326 B.R. 424 (Bankr. Mass. 2005): Denying motion to dismiss a Chapter 7 case for bad faith and stating that such dismissals are limited to extreme misconduct, such as using bankruptcy as a "scorched earth" tactic against a diligent creditor, or using bankruptcy as a refuge from another court's jurisdiction.
- *Society Nat'l Bank v. Barrett*, 964 F.2d 588 (6th Cir. 1992): Affirming denial of motion to dismiss a Chapter 13 case for bad faith where debtor filed multiple bankruptcy cases to stay foreclosure sale.
- *In re Little Creek Dev.*, 779 F.2d 1068 (5th Cir. 1986): Reversing and remanding Bankruptcy Court's decision to dismiss that was based on counsel's admission that bankruptcy was filed to avoid foreclosure, thwart state proceedings and prevent increased bond requirements.
- *In re Nat'l Rifle Ass'n of Am.*, 628 B.R. 262 (Bankr. N.D. Tex. 2021): Dismissing bankruptcy proceeding and finding that the National Rifle Association filed for bankruptcy to gain an unfair litigation advantage and avoid state regulatory schemes.

Additionally, you may contact the United States Trustee Program or the case trustee to try to persuade them that it is appropriate to investigate or consider whether a claim for bad faith is warranted. Both the United States Trustee Program and the case trustee have the ability to inquire about a debtor's actions, challenge a debtor's statements of financial affairs, and obtain information that can assist in building a case of bad faith. Moreover, obtaining the assistance of the United States Trustee Program and the case trustee may bolster the arguments of bad faith, as they are independent entities that do not benefit financially from a dismissal.

How else can the United States Trustee Program play a role in protecting your client's rights and addressing human trafficking issues?

If you are aware of misconduct by a debtor, you are recommended to notify the Office of the United States Trustee in the district where the case was filed and provide any information you have that may help to show that the debtor is seeking to abuse the bankruptcy system. Typically, this contact should be made through the United States Trustee's counsel of record in the case (if one has appeared), or if none has appeared, though the Assistant United States Trustee for the district in which the case was filed. The United States Trustee Program has discretion in deciding what cases it will be involved in, but it can be very helpful to your client if you can persuade them that it is appropriate to get involved. The United States Trustee Program may seek to find out whether the debtor failed to list any assets on its bankruptcy schedules, transferred assets in violation of applicable bankruptcy law, or otherwise abused the bankruptcy system. There are also other federal resources that it may also make sense to contact in some circumstances, such as the Office of Justice Programs, the Department of Homeland Security, and the criminal and civil arms of the Department of Justice. When appropriate, the United States Trustee may make referrals to other agencies, including criminal prosecutors.

SECTION 4. Seeking Discovery About the Debtor

A bankruptcy proceeding can serve as a useful and effective tool to obtain information about a debtor's financial position and the reasons underlying its bankruptcy filing. In bankruptcy, there are generally four primary procedural means by which a creditor may seek to obtain debtor-related information:

- The debtor's petition, bankruptcy schedules and statement of financial affairs,
- The Section 341 meeting of creditors,
- A Bankruptcy Rule 2004 motion, and
- A contested motion or an adversary proceeding.

Each of the four is discussed in turn.

Debtor's Petition, Bankruptcy Schedules and Statement of Financial Affairs

As part of their bankruptcy filing, the debtor is required to file a petition and schedules that contain certain financial-related information, including information about the debtor's property interests (real property, personal property, or investments), any claimed exemptions, creditors with secured and unsecured claims, executory contracts or leases, co-debtors, and income and expenses (for individuals). The debtor is also required to file a statement of financial affairs, which includes marital status (for individuals), income, types of debts and recent payments, any recent transfers of property, legal actions, repossessions or foreclosures, recent losses, account information, the location of assets, and details regarding any affiliation with other businesses.

If the debtor's schedules and statement-related disclosures are incomplete, the clerk may still accept the submission, in which case it would be up to the case trustee, the U.S. Trustee, or another party in interest to bring the deficiencies to the clerk's attention. The purpose of these disclosures is to provide enough information so creditors and other interested parties can determine whether they want to engage in further inquiry.

Minor errors that are not deceptive or prejudicial are not grounds for reducing or eliminating the debtor's rights under the Bankruptcy Code. But a debtor is held to a standard of complete disclosure—it is not enough for a debtor who omits or conceals information to claim that other parties were on "inquiry notice" or should have figured it out anyway. As noted below, inadequate disclosure can be grounds for dismissal or conversion to another chapter. Also, if the debtor fails to file its schedules and/or its statement of financial affairs, the bankruptcy proceeding may be dismissed under Section 521(i) of the Bankruptcy Code.

Section 341 Meeting of Creditors

Shortly after the debtor files the bankruptcy petition, a "341 Meeting" or "First Meeting of Creditors" will be held. Depending upon the bankruptcy chapter, the meeting will be conducted by a case trustee (Chapter 7 or Chapter 13) or by the U.S. Trustee. At the 341 Meeting, the debtor is placed under oath and must answer questions from the trustee and creditors about the schedules and the statement of financial affairs, and how the debtor intends to pay debts and exit bankruptcy. A primary purpose of the 341 Meeting is for the trustee to determine whether there are any nonexempt assets[10] that can be used to pay creditors and to identify any other issues relevant to the administration of the bankruptcy estate. The 341 Meeting is open to the public, and creditors are permitted to attend and have their counsel ask questions about the schedules and statements. This can be an excellent way of getting "free discovery."

Rule 2004 Motion

Unlike the Federal Rules of Civil Procedure, the Federal Rules of Bankruptcy Procedure do not provide an automatic right to take discovery. However, Bankruptcy Rule 2004 allows any interested party to move the Bankruptcy Court for an order allowing the party to examine any entity regarding the debtor's "acts, conduct, property or the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to discharge." In cases under Chapter 11 or Chapter 13, the permitted scope is even broader. This rule permits parties in interest, including the U.S. Trustee or a creditor, to seek information about the debtor's bankruptcy, their assets, the transfer of assets and any conduct surrounding the bankruptcy. Bankruptcy Rule 2004 is quite broad in its scope, and Bankruptcy Courts will generally grant Rule 2004 examinations so long as the request has some color and is not obviously for the purpose of abuse or harassment. Indeed, some courts have even said that it is permissible to use Rule 2004 to conduct a "fishing expedition."

Contested Motions & Adversary Proceedings

If there is a pending "contested matter" or "adversary proceeding" in the bankruptcy case, the Bankruptcy Rules allow parties to the matter to seek additional information by way of traditional discovery methods. An adversary proceeding is the Bankruptcy Court's version of a civil action, and it is initiated by the filing of a formal complaint. A contested matter is more targeted in its focus, and generally involves a less complex legal matter that is handled within the confines of a bankruptcy case, such as an objection to a claim, an objection to a bankruptcy plan, or a motion for relief from stay. The Bankruptcy Rules provide that discovery is permitted for both contested matters (Fed. R. Bankr. P. 9014) and adversary proceedings (Fed. R. Bankr.

[10] Exempt property refers to property (or a certain amount of property) that is protected by the bankruptcy proceeding and cannot be claimed by creditors to satisfy the debtor's obligations. Nonexempt property refers to any other property that may be reached by creditors. It is important to note that the definition of exempt and nonexempt properties may vary from state to state. .

P. 7026-7037) and further provide that documents and testimony can be obtained regarding the relevant issues.

Why might a human trafficking survivor bring an adversary proceeding?

Depending on the facts and procedural circumstances of the bankruptcy case, there are various reasons that a creditor or case trustee might bring an adversary proceeding, including (1) to challenge whether the debtor is entitled to a discharge or a particular debt is dischargeable, (2) to litigate causes of action against the debtor or that otherwise relate to the bankruptcy case (including defending the amount and extent of its claim), or (3) to challenge transfers or sales of property to a third party prior to the bankruptcy as improper. An adversary matter is a full-blown lawsuit within the confines of the Bankruptcy Court, and the bankruptcy judge will oversee all aspects of motion practice, discovery, and resolution of the proceeding.

Why might a human trafficking survivor initiate or be involved in a contested matter?

A contested matter generally arises within the bankruptcy case when a party seeks relief to which another party objects. Depending on the facts and procedural circumstances of the bankruptcy case, a human trafficking survivor may seek to use contested matter practice to object to a proposed bankruptcy plan, seek relief from the automatic stay, or oppose other relief sought by the debtor. This contested matter could occur either because the survivor objects to or opposes relief that another party requests, or because another party objects to or opposes a request by the survivor (*e.g.*, an objection to the survivor's claim).

SECTION 5. Evaluating the Relief to Which Your Client Might Be Entitled in Bankruptcy and Deciding Whether to File a Proof of Claim

The relief to which your client is entitled may differ significantly depending on the facts and circumstances of your client's case. The filing of a proof of claim sets forth the dollar amount that a creditor alleges is owed, and a proof of claim that conforms to the rules has prima facie validity. However, timely filing a claim does not guarantee payment on any or all of the debt your client might be owed. Payment on a claim is typically determined by:

- the type of claim made (e.g., secured, unsecured, contingent),
- the defenses to the claim that the debtor might have,
- the number of other claims, and
- the assets that are available.

At the outset of the bankruptcy case, you will want to evaluate whether your client has a claim against the debtor, the type of claim your client may have, and if the filing of a proof of claim is warranted under the circumstances. Broadly speaking, a claim is a right to payment from the debtor. Generally, a creditor will have one of the following types of claims:

- **Secured**: A secured claim is any debt that is secured by an asset or interest of the debtor.
- **Unsecured**: An unsecured claim is any debt that is not secured by a lien or security interest.
- **Contingent or Unliquidated**: A contingent or unliquidated claim is a claim where the liability or final amount is contingent upon a future event or has not yet been determined.

Each of these three claim types is addressed in turn:

Secured Claim

What is a secured claim?

To have a secured claim, a creditor must be owed a debt and must have a lien on, or security interest in, property in which the debtor has an interest. Outside of bankruptcy, the lien or security interest generally allows the creditor to foreclose on or take the property and sell it at auction, and apply the proceeds to the debt. Secured claims can be voluntary or involuntary. Examples of a voluntary secured claim include a mortgage or automobile loan. Examples of an involuntary secured claim include a real estate tax lien, a mechanic's lien, an income tax lien, a collection order or a judgment lien. A claim is deemed secured only to the value of the collateral securing the claim. The remainder of the claim is deemed unsecured.

If a survivor is entitled to restitution from the debtor as part of a criminal case, is a secured claim established?

No. Although a survivor may be entitled to restitution, the entry of a restitution order does not (at least by itself) render the claim for restitution a secured claim. Upon entry of a restitution order, the government could take steps to provide notice of a judicial lien, but the survivor cannot control the timing of such actions. A survivor could obtain an Abstract of Judgment, but this does not guarantee the establishment of a lien and the survivor would need to take additional steps to create a lien. Generally, restitution orders constitute unsecured nonpriority claims.[11] However, as discussed below, some claims of this kind are not dischargeable in bankruptcy.

Does a lien automatically arise upon entry of a civil judgment?

Most commonly, no. Usually, state law requires the creditor to "perfect" the lien, for example by having it recorded with the county clerk. Some liens may be automatically established, but many others will require perfection or other action. The scope and extent of a lien typically depends on applicable nonbankruptcy law, which is often, but not always, the state law where the property or debtor is located.

What is perfection and why is it important to having a secured claim?

Perfection of a security interest or lien renders the security interest or lien enforceable as against third parties because it provides third parties with notice of the security interest or lien. It establishes that a creditor has a legal right to seize property in place of the payments that are owed. When and how a security interest or lien is perfected usually depends on applicable nonbankruptcy law requirements. In many cases, perfecting a security interest or lien requires filing a document with the appropriate filing agent or registry. In bankruptcy, the trustee or debtor has the rights of a hypothetical lien creditor or bona fide purchaser, and in this capacity, can seek to avoid unperfected security interests. If a security interest or lien is avoided, the underlying debt is treated as a general unsecured claim.

[11] Priority unsecured debts are set out in Section 507 of the Bankruptcy Code and include certain domestic support obligations, taxes, administrative expenses related to the bankruptcy case, wage and benefit claims, and personal injury claims related to the debtor's operation of a vehicle while intoxicated.

Can your client perfect their lien or security interest after the debtor's bankruptcy petition is filed?

Subject to certain exceptions that likely are not applicable in human trafficking cases, generally, a creditor cannot take action to perfect its lien after the bankruptcy petition date.

If your client has a judgment lien, can the debtor avoid it?

Yes, it is possible that your client's judgment lien can be avoided. The debtor may avoid most judgment liens under Section 522(f) of the Bankruptcy Code to the extent that they impair an exemption in property the debtor would otherwise have been entitled to. A lien impairs an exemption to the extent that the amount of liens on the property, plus the exemption the debtor could have claimed on the property but for the liens, exceed the value of the debtor's interest in the property.

Additionally, the Bankruptcy Code offers several means by which a case trustee or debtor in possession can seek to avoid transfers (including a judgment lien) that occurred in the 90 days leading up to the filing of the bankruptcy petition. Pursuant to Section 547 of the Bankruptcy Code, a case trustee or debtor may avoid such transfers and recover them for the benefit of the bankruptcy estate.

Specifically, the case trustee or debtor may avoid any "preferential" transfer (which could be a payment, an asset sale, or a pledge of assets) that is:

- of an interest of the debtor in property;
- to or for the benefit of a creditor;
- for or on account of an antecedent debt;
- made while the debtor was insolvent;
- made within 90 days of the petition date, or if to a relative or insider of the transferor, within one year of the petition date; and
- that enables the creditor to receive more than it would have received in a case under Chapter 7 of the Code if there had been no transfer.

11 U.S.C. § 547(b). The definition of "transfer" in the Bankruptcy Code expressly includes the creation of a lien. 11 U.S.C. § 101(54). Put another way, a judicial lien obtained by a creditor could be avoidable if a lien was placed on the debtor's property within the 90 days preceding the petition date. How a judicial lien arises is typically determined by applicable nonbankruptcy law and the nature of the property (i.e., real or personal). 4 *Collier on Bankruptcy* ¶ 547.03; *Marsh v. Heldt Lumber Co. (In re McCoy)*, 46 B.R. 9, 11 (Bankr. D. Ariz. 1984) ("The event that triggers a perfection under state law . . . determine[s] when the transfer occurred for bankruptcy purposes."). Further, a debtor is presumed insolvent during the 90 days immediately preceding the petition date. 11 U.S.C. § 547(f). A creditor/transferee may defend against a preference action by disputing that the prima facie requirements for a preference have been satisfied, or by proving the applicability of one of the defenses to avoidance set forth in Section 547(c) of the Bankruptcy Code.

In addition, there are also stricter standards for "fraudulent transfers" under 11 U.S.C. § 548, which, if satisfied, the trustee can avoid transfers going back two years before the petition date.

Unsecured Claim

What is an unsecured claim?

An unsecured claim is a right to payment that is not secured by a security interest in, or lien on, property of the debtor. There are priority unsecured claims and nonpriority unsecured claims.

What is a priority unsecured claim?

Priority unsecured claims are claims that, for public policy reasons, have priority over other debts under federal law. Priority unsecured debts are set out in Section 507 of the Bankruptcy Code and include certain tax amounts, bankruptcy administrative expenses, domestic support obligations, and certain legal claims.

Priority unsecured claims are afforded a higher distribution priority over other types of unsecured claims. Certain priority unsecured debts are also nondischargeable, while some claims are priority but dischargeable, some are nonpriority and dischargeable, and some are nonpriority and nondischargeable (as discussed in Section 7, below).

Some claims held by human trafficking survivors could be priority claims—for example, certain types of claims for wages.

What is a nonpriority unsecured claim?

A nonpriority unsecured claim is a claim that does not have any priority status under federal law. Nonpriority unsecured claims could include credit card debt, medical bills, utilities, and personal loans that are incurred before the filing of the bankruptcy. Depending on the nature of the claim and the chapter of the bankruptcy case, this category could also include claims by human trafficking survivors.

Contingent, Unliquidated, and Disputed Claims

Contingent, unliquidated, and disputed claims are those that are not yet determined (either as to liability or dollar amount) at the time the bankruptcy petition was filed, that are contingent upon the occurrence of some future event, or whose existence is in controversy.

- A **contingent claim** is one where the debt obligation depends on an event that has not yet happened and may not necessarily happen, such as when the debtor has provided a guaranty (as a co-signer) of a loan on which a nondebtor is the primary obligor. In the co-signer scenario, as long as the co-signer continues to make payments, the debtor's obligation on the debt may never materialize.
- An **unliquidated claim** is one where the debt obligation is owed but the debtor does not yet know the dollar amount of the obligation. By way of example, an unliquidated claim could arise where the debtor's liability is admitted but damages have not yet been determined.
- A **disputed claim** is a claim where the existence of the obligation is in question. For example, if you have a pending lawsuit in which liability is denied, the claim on which the lawsuit is based is disputed.

Note that a claim can fall into more than one of these categories. For example, if the debtor denies co-signing a loan and it is not clear how much will be due even if the debtor is liable, the debt may be contingent, unliquidated, and disputed. Regardless of whether a debtor believes the debt to be contingent, unliquidated, or disputed, it is required to list the claim in its schedules. If a debtor fails to list your client's claim in their schedules, you must take steps to ensure that your client's rights are protected and to determine what action,

if any, needs to be taken in response. This could include filing a proof of claim for the claim, or bringing an adversary proceeding to contest the debtor's discharge or the discharge of the debt.

How is a contingent, unliquidated, or disputed claim treated in bankruptcy?

A creditor typically must file a proof of claim in order for the claim to be allowed against the debtor. The automatic stay serves to halt all pending civil litigation. To proceed with any pending litigation, the Bankruptcy Court will need to provide relief from the automatic stay or the litigation will need to proceed within the Bankruptcy Court.

Section 502(c) of the Bankruptcy Code provides a mechanism for estimating the amount of any contingent or unliquidated claim where failure to do so "would unduly delay the administration of the case." Accordingly, the Bankruptcy Court can estimate the debtor's liability on a contingent or unliquidated claim for the purposes of allowing the claim and ensure that the bankruptcy proceeding can move forward with confirmation, reorganization, or liquidation.

The Bankruptcy Code does not specify the method or procedure for estimating a claim. Bankruptcy Courts have broad latitude to employ whatever method is best suited to the circumstances, so long as it comports with the legal rules that govern a claim's ultimate value (e.g., contract law). Claims can be estimated through arbitration, mediation, a full-blown trial or any other procedure that the Bankruptcy Court deems appropriate under the circumstances.

What types of claims might exist for survivors of human trafficking?

Human trafficking cases often involve three different types of claims:

- judgment claims;
- claims for unpaid wages; and
- claims for amounts owed as a result of governmental action.

Each is addressed in turn:

Judgment Claim: A judgment claim is one where your client has obtained a final civil judgment against the debtor for a sum of money. If a bankruptcy is filed, the debtor may seek to avoid paying all or a portion of the judgment through the bankruptcy. Whether or not your client will collect on the judgment will depend on a variety of factors, such as the amount of the debtor's assets and liabilities, the type of bankruptcy filed, the court-approved plan for repayment of the debtor's creditors, and the steps taken by your client to enforce the judgment prior to the bankruptcy. If the judgment gives rise to a lien on property, your client could have a secured claim up to the value of the property to which the lien attaches. The creation of a judgment lien is generally a matter of state law. The attachment of the lien allows the creditor to assert a secured claim against the debtor and have a greater likelihood of some recovery against the debtor. If a lien has not attached prepetition, your client would likely have an unsecured claim, which could receive little, if any, payment.

Case Example: In *In re Signal International LLC*, Case No. 15-11498 (Bankr. D. Del.), former employees of Signal International obtained a civil judgment of approximately $14 million dollars, with multiple federal trafficking cases still pending. After Signal International filed for bankruptcy, the former employees were able

to secure approximately $20 million dollars in payments to former employees through the bankruptcy plan to satisfy the civil judgment and other employee obligations.

Claims for Unpaid Wages: A claim for unpaid wages or disbursements will often be considered a priority unsecured claim as dictated by the Code. Section 507(a) of the Bankruptcy Code sets forth priority claims for unpaid wages and contributions to employee benefit plans. The priority claim extends to wages, salaries, commissions, severance pay and other forms of compensation that were earned within 180 days prior to the date of the bankruptcy filing or the cessation of the debtor's business, whichever occurred earlier. It also includes claims for contributions to employee benefit plans that arise from services provided within 180 days before the debtor filed for bankruptcy or ceased doing business, whichever is earlier. Both of these priorities only apply up to a certain amount per individual ($15,150 as of April 1, 2022). Finally, to the extent that an employee continues to work after the bankruptcy filing, the employee may have a priority claim for wages and salary if the expenses are considered an actual and necessary expense to preserve the debtor's assets. To the extent that your client is or was an employee of the debtor, you should consider whether your client should make a claim for unpaid amounts.

Claims Arising From Government Action: A government-based claim arises when a governmental unit has enforced certain federal or state laws against the debtor resulting in amounts owed to a survivor(s). By way of example, a survivor could have a right to recoup amounts owed as a result of proceedings brought by the EEOC, proceedings arising from claims under the Fair Labor Standards Act or state law equivalent, or restitution orders arising from criminal convictions. Criminal restitution arising from the federal or state prosecution of the trafficker gives rise to such a government-based claim.

SECTION 6. Filing a Proof of Claim (if Warranted)

Is the filing of a proof of claim always warranted?

In order for a creditor to receive a distribution in the bankruptcy case on debt owed to it, it generally must file a proof of claim. Fed. R. Bankr. P. 3002(a). A proof of claim is a document filed with the Bankruptcy Court that describes the type and amount of the claim a creditor asserts against the bankruptcy estate. Once you have reviewed the bankruptcy proceeding and your client's rights, you should consider whether to file a proof of claim. By filing a proof of claim, your client can ensure that they assert their right to repayment, identify the full amount they believe they are owed, and provide evidence to substantiate their claim. If a proof of claim is not filed, the creditor may not have an allowed claim that is entitled to any distribution, unless the debtor or case trustee files a claim on the creditor's behalf.

However, there may be instances in which your client decides it is in their best interest not to file a proof of claim. For example, your client may have little likelihood of recovery because they have an unsecured claim in a very small dollar amount. In that event, your client may determine it is not worth the time and effort to file a proof of claim. In addition, there may be other reasons why your client might not want to file a proof of claim. The filing of a proof of claim causes the creditor to submit to the jurisdiction of the Bankruptcy Court, and effects a waiver of the creditor's jury trial rights (although avoiding such a waiver may have little practical benefit, because not filing a claim could effectively result in the complete waiver of the claim if the debtor receives a discharge). In light of these considerations, a creditor might determine that filing a proof of claim is not in its best interests.

Additionally, if a case trustee in a Chapter 7 case determines that the debtor's estate has no nonexempt assets, the case trustee may instruct creditors not to file proofs of claim. If the case trustee later discovers assets, the case trustee will file a notice that identifies the assets and sets a date by which all claims must be filed.

If your client only has a potential cause of action (e.g., not a judgment), does your client need to file a proof of claim?

Potential causes of action are still "claims" under the Bankruptcy Code and they can still be subject to discharge. Therefore, it would be prudent to file a proof of claim if you have a potential cause of action or pending claim, and if taking into account all of the relevant facts and circumstances, it is in your client's interest to do so. Section 502(c) of the Bankruptcy Code provides that claims may be estimated if identifying or fixing the actual amount of the claim would unduly delay the administration of the estate.

What is the legal effect of not filing a proof of claim?

Rule 3002(c) of the Federal Rules of Bankruptcy Procedure sets forth the bar date or deadline for filing proofs of claims. In most Chapter 7 and 13 cases, this is 70 days from the date on which the petition was filed. Claims that are timely filed are considered to be prima facie valid in the amount claimed. Claims that are not timely filed run the risk of being rendered invalid, may not receive a distribution from the bankruptcy estate, and may be subject to discharge. If a proof of claim is filed after the bar date, the creditor must be prepared to argue that the failure to timely file the claim was due to excusable neglect. The failure to timely file a proof of claim may lead to the disallowance of the claim and preclude your client from receiving any payment on the claim.

What happens if the debtor objects to your client's claim?

A timely filed proof of claim is prima facie evidence of the validity and amount of the debt. The debtor or trustee, however, may object to a creditor's claim, and if it rebuts the prima facie validity, it will place the burden on the creditor to prove that the claim is valid. Objections to claims frequently contest: (1) the classification of the claim as secured or unsecured, or priority or nonpriority, (2) the amount of the claim, or (3) the legitimacy of the claim. The process and timing for responding to a claim objection may vary by jurisdiction and by the specific case, and a review of the Federal Rules of Bankruptcy Procedure and local rules are important to understand the steps that must be taken to timely respond to a claim objection. The failure to respond to the objection may lead the Bankruptcy Court to sustain the objection and disallow the claim.

SECTION 7. Evaluating the Impact of a Discharge

If your client has a claim against the debtor, you may want to consider taking steps to contest the debtor's ability to discharge its personal liability for the debt.

A discharge in bankruptcy releases the debtor from personal liability for certain debts that are dischargeable. Not all debts are dischargeable, however, as discussed in greater detail below.

Because a discharge permanently bars creditors from taking actions to collect on discharged debt as a personal liability of the debtor, it is one of the most fundamental protections offered under the Bankruptcy Code. A creditor that seeks to collect a discharged debt can be subject to sanctions and fines. It is important to note, however, that a discharge only alleviates a debtor's personal liability for a discharged debt; it does

not impair a creditor's *in rem* rights, that is, rights that are held in property. Accordingly, a creditor that is secured by a lien on property may still take action to enforce their lien against the property, notwithstanding the discharge.

Are all debtors entitled to receive a discharge?

No, not all debtors are entitled to receive a discharge. Some of the common reasons why a debtor may not receive a discharge include:[12]

- The debtor recently received a discharge in a prior bankruptcy proceeding.
- The Chapter 7 debtor is not an individual.
- The Chapter 7 debtor has committed certain bad acts in connection with the bankruptcy case or has hidden assets from creditors.
- The Chapter 13 debtor, or individual Chapter 11 debtor, did not complete his or her bankruptcy plan.

Chapter-specific reasons why a debtor may not be eligible for a discharge are set forth in 11 U.S.C. §§ 727, 1141, 1228, and 1328.

Are all debts subject to discharge?

No, not all debts are subject to discharge. Even if a debtor receives a discharge, there could be a number of debts that are excepted from the discharge and for which the debtor will remain personally liable. Some of the common reasons why a debt may not be dischargeable include:

- The debt was not listed on the debtor's bankruptcy schedules, and the creditor did not have notice of the bankruptcy in time to permit timely filing of a proof of claim.
- In Chapter 7 and individual Chapter 11 cases,[13] if the debt arose from:
    - The willful and malicious injury by the debtor to another entity or to the property of another entity. 11 U.S.C. § 523(a)(6).
    - An order of restitution issued under title 18 of the United States Code. 11 U.S.C. § 523(a)(13).
- In Chapter 13 cases, if the debt is for:
    - Restitution or a criminal fine included in a sentence on the debtor's conviction of a crime. 11 U.S.C. § 1328(a)(3).

[12] For more detailed information regarding the different bankruptcy chapters, the individuals or entities that are entitled to protection, and the manner in which the proceedings operate, please see Addendum A.

[13] 11 U.S.C. § 523(a). These exceptions also apply to a Chapter 13 debtor that is granted a hardship discharge despite noncompletion of plan payments under 11 U.S.C. § 1328(b). 11 U.S.C. § 1328(c).

- Restitution or damages awarded in a civil action against the debtor as a result of willful or malicious injury by the debtor that caused personal injury to an individual or the death of an individual. 11 U.S.C. § 1328(a)(4).[14]

Chapter-specific exceptions to discharge of particular debts are set forth in 11 U.S.C. §§ 727, 1141, 1228, and 1328. Other exceptions to discharge applicable to debtors in Chapter 7 and individuals in Chapter 11 are set forth in 11 U.S.C. § 523(a). With respect to debtors in Chapter 13, only certain of the exceptions in Section 523(a) typically apply. 11 U.S.C. § 1328(a)(2). However, all of the exceptions in Section 523(a) apply to Chapter 13 debtors that receive hardship discharges under Section 1328(b). 11 U.S.C. § 1328(c).

What steps need to be taken to ensure that a debt is not discharged?

Pursuant to Section 523(a) of the Bankruptcy Code, which is broadly applicable to Chapter 7 debtors, individual Chapter 11 debtors, and Chapter 13 debtors that receive a hardship discharge under Section 1328(b) of the Bankruptcy Code, certain types of debt are excepted from discharge, including payment of an order of restitution issued under title 18 of the United States Code, and in certain circumstances, debts that are not listed in the debtor's bankruptcy schedules. 11 U.S.C. § 523(a). In discharges under Section 1328(a), some (but not all) of the same exceptions apply, as well as some additional ones.

Some of these exceptions apply automatically, so that a creditor does not need to obtain a ruling from the Bankruptcy Court during the bankruptcy case. However, some exceptions from discharge apply only if the creditor obtains a timely determination from the Bankruptcy Court. Of the debts excepted under Section 523, the creditor must obtain a ruling to invoke exceptions under Sections 523(a)(2) (certain debts obtained through falsehood, and certain eve-of-filing consumer debts), 523(a)(4) (debts relating to fiduciary fraud, embezzlement, and larceny), and 523(a)(6) (willful or malicious injury), and 523(c)(1). As discussed below, a creditor seeking to except such debt from discharge, or seeking to deny a debtor a discharge altogether, must file a complaint in accordance with the time limitations set forth in Fed. R. Bankr. P. 4007. As to such debts, the bankruptcy court has exclusive jurisdiction to determine dischargeability. 11 U.S.C. § 523(c)(1).

Practice Pointer: As of the date of this publication, there is nothing in the Bankruptcy Code that automatically excepts claims under the Trafficking Victims Protection Act (TVPRA) from discharge.[15] However, the factual allegations that may substantiate a TVPRA claim may also be sufficient for a nondischargeability claim. *See Murray v. Altendorf (In re Altendorf),* Adv. No. 15-07003, 2015 WL 4575219 (Bankr. D.N.D. July 29, 2015) (denying motion to dismiss plaintiffs' nondischargeability claims under 11 U.S.C. §§ 523(a)(2)(A) and 523(a)(6) that were based upon and incorporated by reference plaintiffs' pre-petition lawsuit against the debtor in which plaintiffs asserted claims under the TVPRA, among others); *Lama v. Malik*, 58 F. Supp. 3d 226 (E.D.N.Y. 2014) (denying motion to dismiss employment-related claims on grounds that the allegations would fall into the nondischargeable exceptions in 11 U.S.C. 523(a)(2)(A) and 523(a)(6)).

[14] Bankruptcy Courts generally hold that "personal injury" includes both physical ham and nonphysical harm (such as emotional distress or defamation). *In re Ang*, 589 B.R. 165, 180 (Bankr. S.D. Cal. 2018); *In re Szewc*, 568 B.R. 348, 358 (Bankr. D.Or. 2017); *In re Adams*, 478 B.R. 476, 486 (Bankr. N.D. Ga. 2012).

[15] As of the date of publication, there is a bill pending with Congress that would make claims for injuries under 18 U.S.C. §1581, et seq. nondischargeable under the Bankruptcy Code. If and when the bill passes, practitioners will need to determine which arguments to make in connection with establishing the nondischargeability of the debt.

What if your client's claim is not automatically excepted from discharge? What grounds must your client allege to seek nondischargeability status for its claim?

Your client can request that the debt be deemed nondischargeable. There are a number of grounds that may provide a basis for a Bankruptcy Court to determine that a particular debt is excepted from discharge. The specific facts and circumstances of your client's case, as well as the bankruptcy chapter under which the case is pending, will dictate the grounds that are most applicable. However, in the context of a claim for human trafficking, common grounds for nondischargeability may include:

Willful and Malicious Injury Exception (11 U.S.C. § 523(a)(6))

A debt is nondischargeable under Section 523(a)(6) of the Bankruptcy Code if it arises from "willful and malicious injury by the debtor to another entity or the property of another entity." 11 U.S.C § 523(a)(6). This discharge exception is generally limited to conduct that is classified as an intentional tort, and covers deliberate or intentional injuries. *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998). "The requirements of 'willfulness' and 'maliciousness' are distinct requirements in the statutory text and are usually treated as such by the courts." 4 *Collier on Bankruptcy* ¶ 523.12[2] (16th ed.). A creditor seeking to establish that a debt is nondischargeable under Section 523(a)(6) must bring a complaint during the bankruptcy case and must comply with the deadlines set forth in Fed. R. Bankr. P. 4007. The Bankruptcy Court will determine the applicability of the exception after notice and a hearing. 11 U.S.C. § 523(c). There is a somewhat similar exception found in Section 1328(a)(4), which excepts from discharge in Chapter 13 cases debts "for restitution, or damages, awarded in a civil action against the debtor as a result of willful or malicious injury by the debtor that caused personal injury to an individual or the death of an individual." 11 U.S.C. § 1328(a)(4). However, note that there are some significant differences—for example, Section 1328(a)(4) only requires that the injury be either willful or malicious, not both; and it only applies in situations in which the conduct caused an individual's personal injury or death; it does not on its face cover injury to property; and it does not cover criminal restitution (though at least some types of criminal restitution would be covered under Section 1328(a)(3)).

Case Law Example: *In re Larsen*, 422 B.R. 913, 921 (Bankr. E.D. Wis., 2010), *aff'd sub nom. Larsen v. Jendusa-Nicolai*, 442 B.R. 905 (E.D. Wis. 2010), *aff'd*, 677 F.3d 320 (7th Cir. 2012). The Bankruptcy Court held that the damages a debtor owed to his wife as a result of a state court's civil findings on counts for kidnapping and domestic violence were not dischargeable under Section 523(a)(6) of the Bankruptcy Code. *Id*.

Doe v. Boland (In re Boland), 596 B.R. 532 (6th Cir. B.A.P. 2019). The Bankruptcy Appellate Panel of the Sixth Circuit held that a civil judgment for statutory damages entered in favor of victims of debtor's possessory child pornography offense was excepted from discharge under Section 523(a)(6).

Hoewischer v. White (In re White), 551 B.R. 814 (Bankr. S.D. Ohio 2016). The Bankruptcy Court held that debt arising from a state court judgment against the debtor for invasion of privacy, which resulted from the debtor's posting of nude photographs of the judgment creditor as well as her home address on a revenge porn website, was excepted from discharge under Section 523(a)(6).

Fraud Exception (11 U.S.C. § 523(a)(2)(A))

A debt is nondischargeable under Section 523(a)(2)(A) if the debt arises from "money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by… false pretenses, a false representation, or actual fraud . . . ." 11 U.S.C. § 523(a)(2)(A). To establish that a debt is nondischargeable

under this exception, a creditor must show that money, property or services were obtained by false pretenses, false representations, or actual fraud. 4 *Collier on Bankruptcy* ¶ 523.08[1][a] (16th ed.). "The purposes of the provision are to prevent a debtor from retaining the benefits of property obtained by fraudulent means and to ensure that the relief intended for honest debtors does not go to dishonest debtors." *Id*. Like the exception for willful and malicious injury, a creditor seeking to establish that a debt is nondischargeable under Section 523(a)(2)(A) must bring a complaint during the bankruptcy case and must comply with the deadlines set forth in. Fed. R. Bankr. P. 4007.

Case Law Example: *Cohen v. de la Cruz,* 523 U.S. 213 (1998) (landlord's liability for charging rent in excess of local rent control ordinance was nondischargeable; affirmed ruling that landlord's conduct amounted to an "unconscionable commercial practice," and that punitive treble damages award was nondischargeable).

Restitution or Criminal Damages Exception (11 U.S.C. §§ 523(a)(13); 1328(a)(3))

Under Section 523(a)(13), a debt for payment of a restitution order issued under the federal criminal code is nondischargeable. "Under this subsection, the Court 'does not redetermine whether a debtor is guilty of a title 18 crime and/or whether restitution should be awarded in connection with the crime. The court merely determines whether the order at issue has imposed an obligation that is in the nature of 'restitution' and whether it was issued under the federal criminal code.'" *Doe v. Martinez (In re Martinez)*, Adv. No. 10-1039, 2012 WL 1641926, at *10 (Bankr. D.N.M. May 10, 2012). This exception applies only to restitution orders for criminal offenses under title 18; it does not apply to restitution orders issued in state criminal prosecutions. *Id.*

In Chapter 13 cases, there is an exception to discharge under Section 1328(a)(3) for debts "for restitution, or a criminal fine, included in a sentence on the debtor's conviction of a crime." 11 U.S.C. § 1328(a)(3). Section 1328(a)(3) is broader than the comparable exception in Section 523(a)(13), because it can apply to criminal restitution orders under state law, not just federal law. 4 *Collier on Bankruptcy* ¶ 523.19 (16th ed.). However, the exception only applies when the restitution order or fine results from conviction of a crime and is included in the sentence. 4 *Collier on Bankruptcy* ¶ 1328.02[j] (16th ed.).

Lack of Notice Exception (11 U.S.C. § 523(a)(3))

Section 523(a)(3) excepts from discharge debts that were not scheduled by the debtor in time to permit the creditor to take timely action to protect its rights, unless the creditor had notice or actual knowledge of the bankruptcy case. 11 U.S.C. § 523(a)(3); 4 *Collier on Bankruptcy* ¶ 523.09[1] (16th ed.) ("Section 523(a)(3) concerns itself with protecting a creditor's right to receive a distribution through the filing of a timely proof of claim and a creditor's right to seek a determination of dischargeability of a debt under sections 523(a)(2), (a)(4) and (a)(6)."). Pursuant to Section 523(a)(3)(A), if the debtor's failure to schedule the debt prevented the creditor from timely filing a proof of claim, the debt is nondischargeable. Under Section 523(a)(3)(B), if the debtor's failure to schedule the debt prevented the creditor from timely requesting a determination of dischargeability under Sections 523(a)(2), (a)(4) and (a)(6), and the debt is of the kind specified in such subsections, the debt is nondischargeable.

Case Law Example: *Chapin Home for the Aging v. McKimm*, No. 11-CV-00667, 2015 WL 1237830, at *2 (E.D.N.Y. Mar. 17, 2015). Creditor's intentional tort claims, which were "clearly 'of a kind specified in' §§ 523(a)(2)(A) and (a)(6)," survived the debtor's discharge where the debtor failed to include creditor's intentional tort claims on its schedules and creditor did not have actual knowledge or notice of the bankruptcy in time to participate in the case.

Additional grounds for nondischargeability are found in Sections 523, 727, 1141, and 1328 of the Bankruptcy Code.

Who bears the burden of proof?

The creditor seeking to render a debt nondischargeable bears the burden of proving that a particular exception to discharge applies. Fed. R. Bankr. P. 4005 ("At the trial on a complaint objecting to a discharge, the plaintiff has the burden of proving the objection.").

Is it sufficient to append a judgment to the complaint and let the judgment speak for itself?

No, not necessarily. Even if your client has obtained a pre-bankruptcy judgment establishing the debtor's liability for a particular debt, the complaint must allege the specific factual and legal basis under the Bankruptcy Code required to show that a debt is not dischargeable or that a debtor's discharge should be denied. That said, if a court has already adjudicated an issue, or entered judgment on facts that form the basis for a discharge exception, principles of res judicata or collateral estoppel may preclude a debtor from challenging the merits of the complaint. *See In re Smith,* 537 B.R. 1, 9–10 (Bankr. M.D. Ala. 2015) (debtor could not challenge merits of creditor's claim for dischargeability exception under Section 523(a)(6) because default judgment had previously entered on sexual harassment claim against debtor). In that situation, the prudent course is to explicitly assert estoppel in the complaint.

What if your client has not yet obtained a judgment against the debtor? Does this mean your client cannot file a complaint challenging the discharge of a debt?

Whether or not the basis for a dischargeability exception needs to be proven in a different court before your client files a nondischargeability complaint largely depends on the applicable exception to discharge, and to some degree, the jurisdiction. For instance, the discharge exception under Section 523(a)(13), for "payment of an order of restitution issued under title 18," necessarily implies that there be a preexisting order of restitution entered under the federal criminal code. *See Doe v. Martinez (In re Martinez)*, Adv. No. 10-1039, 2012 WL 1641926, at *10 (Bankr. D.N.M. May 10, 2012). Moreover, 28 U.S.C. § 157(b)(5) provides that "[t]he district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claims arose, as determined by the district court in which the bankruptcy case is pending." 28 U.S.C. § 157(b)(5). Accordingly, Bankruptcy Courts frequently grant plaintiffs relief from the automatic stay, and district courts have withdrawn the reference, to allow personal injury tort claims to be decided outside of bankruptcy to establish a basis for the Bankruptcy Court's determination of dischargeability. *In re Martinez*, 2012 WL 1641926, at *1–2; *Goldschmidt v. Erickson (In re Erickson)*, 330 B.R. 346, 349 (Bankr. D. Conn. 2005) (noting that the Bankruptcy Court "has exclusive jurisdiction to adjudicate its dischargeability once such claim is liquidated."); *but see In re Murphy*, 569 B.R. 402 (Bankr. E.D.N.C. 2017) (court could adjudicate malicious prosecution claim in connection with nondischargeability complaint where parties consented to the court's adjudication). Your client can institute proceedings before the Bankruptcy Court seeking a nondischargeability determination.

When must the creditor bring a complaint to except a debt from discharge or to object to the debtor's discharge?

Generally, the deadlines for seeking to except a debt from discharge are set forth in Rule 4007. The deadlines for bringing a complaint objecting to discharge are set forth in Rule 4004. The timing of a debtor's discharge, and, correspondingly, the deadline to object to entry of a debtor's discharge, depends upon the

chapter under which the bankruptcy case is pending. Under Rule 4004(b), the Bankruptcy Court may, upon motion of a party in interest, extend the time to object to discharge, but the request for an extension must be filed before the time has expired, except for motions based on newly discovered evidence.

With respect to challenges to the dischargeability of particular debts, a proceeding to determine the dischargeability of a debt under Section 523(c) (which encompasses Sections 523(a)(2) and (a)(6)), must be brought within the time set by Fed. R. Bankr. P. 4007(c)-(d). Specifically, except as specified in Bankruptcy Rule 4007(d) (discussed below in the context of Chapter 13 cases specifically), in Chapter 7 and 13 cases, the deadline to file a complaint to determine the dischargeability of a particular debt under Section 523(c) must be filed no later than 60 days after the first date set for the meeting of creditors under Section 341(a), and the court shall give no less than 30 days' notice of such deadline. Fed. R. Bankr. P. 4007(c). Rule 4007(b) provides that if the complaint to determine nondischargeability is not based on Section 523(c), it may be brought at any time.

The timing of a debtor's discharge, and the deadline for contesting a debtor's entitlement to receive a discharge, varies by the chapter under which the case is pending:

Chapter 7: Discharge tends to enter relatively quickly in Chapter 7 cases. The deadline for parties to object under 11 U.S.C. § 727(c)(1) to the debtor's discharge is 60 days after the first date set for the meeting of creditors under Section 341 of the Bankruptcy Code. *See* Fed. R. Bankr. P. 4004(a). This is the same deadline as that under Rule 4007(c) to seek to have a debt found nondischargeable under Section 523(c). Thus, it is important for creditors of Chapter 7 debtors to act promptly in bringing their complaint challenging discharge.

Chapter 11: In individual Chapter 11 cases, the Bankruptcy Court generally grants a discharge after the debtor completes all of their payments under a confirmed plan of reorganization. 11 U.S.C. § 1141(d)(5). In nonindividual Chapter 11 cases, the discharge typically occurs at the time of plan confirmation. 11 U.S.C. § 1141(d)(1)(A). (However, nonindividual debtors that use Chapter 11 for purposes of liquidation rather than reorganization do not receive discharges.) The deadline for parties to object to the debtor's discharge is the first date set for the hearing on confirmation of the debtor's plan. Fed. R. Bankr. P. 4004(a).

Chapter 13: In a Chapter 13 case, a motion objecting to the debtor's discharge under Section 1328(f) of the Bankruptcy Code must be filed no later than 60 days after the date first set for the meeting of creditors under Section 341 of the Bankruptcy Code. Fed. R. Bankr. P. 4004(a). Here, too, the deadline is the same as that under Rule 4007(c) to seek to have a debt found nondischargeable under Section 523(c).

In a Chapter 13 case where the debtor requests a hardship discharge under Section 1328(b) prior to completing plan payments, the Bankruptcy Court will enter an order fixing the time to file a complaint to determine the dischargeability of a debt under Section 523(a)(6) for willful and malicious injury (Section 523(a)(6) is applicable in Chapter 13 only when the debtor requests a hardship discharge), and shall give no less than 30 days' notice of the deadline. Fed. R. Bankr. P. 4007(d).

SECTION 8. Other Miscellaneous Considerations

Can class claims be brought against the debtor in a bankruptcy proceeding?

At least in some circumstances, yes. There are two methods by which class claims may be asserted against a debtor: (A) the filing of a class proof of claim and (B) the filing of a class adversary proceeding pursuant to Rule 7023 of the Federal Rules of Bankruptcy Procedure.

A class proof of claim is permitted where the class has been certified prior to filing for bankruptcy. *See In re Trebol Motors Distrib. Corp.*, 220 B.R. 500 (B.A.P. 1st Cir. 1998); *In re Baldwin-United Corp.*, 52 B.R. 146 (Bankr. S.D. Ohio 1985). If a class has not yet been certified, courts are split on whether an individual creditor is authorized to assert a claim on behalf of a group of potentially unnamed individuals. Recent circuit court cases suggest that courts can use their discretion to accept class proofs of claims and evaluate them under Bankruptcy Rule 7023. *See, e.g., Gentry v. Siegel*, 668 F.3d 83 (4th Cir. 2012); *In re Birting Fisheries, Inc.*, 92 F.3d 939 (9th Cir. 1996)*; Reid v. White Motor Corp.*, 886 F.2d 1462, (6th Cir. 1989), *cert. denied*, 494 U.S. 1080 (1990); *In re Charter Co.*, 876 F.2d 866 (11th Cir. 1989), *cert. dismissed,* 496 U.S. 944 (1990); *In re Amer. Reserve Corp.*, 840 F.2d 487 (7th Cir. 1988).

Rule 7023 permits class actions to be brought as an adversary proceeding, provided the requirements of Fed. R. Civ. P. 23 are satisfied. *See, e.g., Bolin v. Sears, Roebuck & Co.*, 231 F.3d 970 (5th Cir. 2000) (certification denied); *Bessette v. Avco Financial Services, Inc.*, 230 F.3d 439 (1st Cir. 2000); *In re Walls*, 262 B.R. 519 (Bankr. E.D. Cal. 2001) (failure to meet Rule 23 tests); *In re Tate*, 253 B.R. 653 (Bankr. W.D.N.C. 2000); *In re Aiello*, 231 B.R. 693 (Bankr. N.D. Ill. 1999) (claim based on bankruptcy law).

If a creditor initiates an adversary proceeding against the debtor in Bankruptcy Court, can the debtor assert counterclaims against the creditor?

If an adversary proceeding is brought against the debtor, the debtor may assert counterclaims pursuant to Fed. R. Bankr. P. 7013. However, there are limits on the Bankruptcy Court's ability to adjudicate such claims. *See Stern v. Marshall,* 564 U.S. 462 (2011). Particularly when such claims are based on state law, the Bankruptcy Court in some cases will only be able to adjudicate the claims if all parties have given voluntary and knowing consent to the Bankruptcy Court's adjudication. *See Wellness Int'l Network, Ltd. v. Sharif*, 575 U.S. 665 (2015).

Could your client's own prior bankruptcy filing impact their ability to file a claim or prevail in civil litigation?

Yes, your client's prior bankruptcy filing could possibly affect your client's right of recovery.

If your client previously filed for bankruptcy and failed to identify their potential claim(s) against the trafficker (if it existed at that time), the trafficker may argue that your client is judicially estopped from bringing the civil lawsuit or filing a claim. The trafficker may argue that the claim should have been disclosed and included as part of the bankruptcy estate and that the failure to do so precludes any recovery. Additionally, the trafficker may argue that your client lacks standing to bring the claim because the claim belongs to your client's bankruptcy estate.

Relevant Case Law: *Burnes v. Pemco Aeroplex Inc.*, 291 F.3d 1282 (11th Cir. 2020) (claim for monetary damages for employment discrimination dismissed under judicial estoppel arguments where potential claim not identified in bankruptcy proceeding); *Van Horn v. Martin,* 812 F.3d 1180 (8th Cir. 2016) (debtor barred

by judicial estoppel from pursuing cause of action that arose one month before end of Chapter 13 case because debtor did not amend schedules to disclose it); *Dzakula v. McHugh*, 746 F.3d 399 (9th Cir. 2014) (affirming dismissal of complaint alleging employment discrimination on judicial estoppel grounds due to plaintiff's failure to disclose claim on her bankruptcy schedules, even though she later amended her schedules to include claim after defendant moved to dismiss); *Williams v. Hainje*, 375 Fed. Appx. 625, 2010 WL 1936269 (7th Cir. 2010) (former debtor judicially estopped from pursuing civil rights claims that debtor failed to disclose during bankruptcy proceeding); *Guerpo v. Amresco Residential Mortg. Corp.*, 13 Fed. Appx. 649, 650 (9th Cir. 2010) (debtor's prepetition TILA rescission claims became part of the bankruptcy estate and debtor lacked standing to pursue them); *Eastman v. Union Pac. R. Co.*, 493 F.3d 1151 (10th Cir. 2007) (railroad worker was judicially estopped from pursuing personal injury action where he failed to disclose the action in his bankruptcy case); *Krank v. Utica Mut. Ins. Co.*, 109 B.R. 668 (E.D. Pa.), *aff'd*, 908 F.2d 962 (3d Cir. 1990) (debtor not permitted to enforce prepetition cause of action not listed in schedules without reopening bankruptcy case and giving trustee opportunity to enforce or abandon cause of action).

In response to such arguments, it is important to understand the timing of the bad acts and whether your client knew of the claim(s) at the time of the client's original bankruptcy filing. For example, if the purported bad acts continued into the post-petition time frame, your client may be able to argue that the current civil litigation is based on post-petition activity. Additionally, it may be necessary to inquire about whether your client knew or understood that the activity was a violation of their rights at the time of the original bankruptcy. The purpose of judicial estoppel is to prevent a party from deriving an unfair advantage or imposing an unfair detriment on the opposing party by asserting inconsistent positions. Here, you may consider arguing that your client is not deriving an unfair advantage because at the time of the prior bankruptcy filing, your client was not in a position to either know or assert a claim against the trafficker. For example, you could argue that because of the way the trafficker treated your client, your client could not have identified a potential claim in the bankruptcy without suffering repercussions from the trafficker. Additionally, if you can demonstrate that the failure to list the potential claim arose from mistake or inadvertence, a Bankruptcy Court may find that judicial estoppel does not apply.

Another potential avenue would be to seek to re-open the bankruptcy case in order to amend your client's schedules or ask the trustee to pursue the claim. Because Bankruptcy Courts may have different standards regarding the re-opening of the bankruptcy case and amending the schedules, local practice and procedure must be analyzed to determine the viability of this solution. Relevant considerations include the time delay in seeking to re-open the bankruptcy, the impact of the amendment of the schedules on the payment of the debt or discharge, and the facts surrounding your client's omission of the potential claim from the original schedules.

Conclusion

Trafficking survivors often struggle to assert their rights against their traffickers. Criminal restitution orders, particularly in sex trafficking cases, are rarely enforced. And survivors can wait years for satisfaction of civil judgments in trafficking cases brought under 18 U.S.C. § 1595. Traffickers, who use force, fraud, and coercion to hold victims in servitude, may resort to the bankruptcy system to thwart efforts to compensate those victims. Armed with the information in this guide, and with qualified legal counsel, trafficking survivors can combat this abuse of the legal process. In the words of one survivor, "It is vital that survivors have a pro bono attorney to walk them through the entire case from beginning to end." And that includes the bankruptcy case.

ADDENDUM A: Introductory Bankruptcy Concepts

To understand the impact of bankruptcy, it is important to understand what "bankruptcy" is and the impacts that it can have on your client's ability to recover amounts owed.

What is bankruptcy?

Bankruptcy is a process designed to provide financial relief to organizations and individuals who are experiencing the burdens of debt. Article I, Section 8, clause 4 of the U.S. Constitution leaves the power to enact bankruptcy laws solely to the U.S. Congress. The Bankruptcy Code (Title 11 of the United States Code) is the federal law that governs all bankruptcy proceedings, including how and when individuals and businesses may restructure their debts or have them discharged entirely. The Bankruptcy Court is the centralized forum that oversees how debts and assets are identified and classified, the amounts that are paid to creditors, and the discharge of any debts. The Bankruptcy Court is a federal court under the United States District Court. United States District Courts generally refer all cases under Title 11 to the Bankruptcy Court automatically under an Order of Reference.

What are the most common types of bankruptcy cases?

There are different chapters of the Bankruptcy Code. Which chapter a particular debtor files under will generally depend upon such circumstances as whether the debtor is an individual or a business entity, how much debt the debtor has, whether the debtor has regular income, and whether the debtor seeks to liquidate assets or reorganize. The three most common types of bankruptcy cases are Chapter 7, Chapter 11, and Chapter 13:

In a **Chapter 7 bankruptcy**, a trustee is appointed to liquidate the debtor's (either an individual or an entity) assets and make distributions to creditors, subject to certain exemptions and priority rights. Generally, unsecured creditors will be paid from the bankruptcy estate only if there are assets available to be liquidated and the creditor files a proof of claim. In most cases, the debtor has no nonexempt assets to be liquidated. With most individual Chapter 7 cases, the debtor will receive a discharge just a few months after the petition is filed (there is no discharge in a corporate Chapter 7 case), and the discharge will release the debtor from personal liability for their dischargeable debts. All liens survive the case's end. Individual debtors with mostly consumer debt have to pass a "means test" of their income and expenses to avoid dismissal.

In a **Chapter 13 bankruptcy**, an individual debtor with a regular source of income and with unsecured and secured debts under set dollar limits files a plan to pay back all or a portion of the debtor's debts. Chapter 13 bankruptcy avoids liquidation and allows the debtor to keep valuable assets. If the proposed repayment plan meets the requirements of the Bankruptcy Code, the debtor's plan will be confirmed by the Bankruptcy Court, and a case trustee will administer the plan. In contrast to a Chapter 7 bankruptcy, a Chapter 13 debtor does not receive an immediate discharge of debts. Instead, a discharge issues only after the debtor makes all required payments under the plan. While the plan is in effect, the debtor is protected from lawsuits, garnishments, and other collection actions. In this chapter, liens without adequate security can be "stripped off" to the extent that they are undersecured.

In a **Chapter 11 bankruptcy**, business entities can continue to operate and repay creditors through a court-approved plan of reorganization. Individuals can also be debtors under Chapter 11, although this rarely occurs unless they incurred more debt than the limits set for a Chapter 13 proceeding. Under Chapter 11, the debtor generally has the right to file a plan of reorganization, and the debtor must provide creditors with

a disclosure statement containing adequate information to enable creditors to evaluate the plan. The Bankruptcy Court will review and confirm or disapprove of the plan of reorganization. Under a confirmed plan, the debtor can reduce its debts by repaying some portion of the amounts owed while other obligations are discharged. The debtor can also assume or terminate certain contracts and leases, recover assets and rescale its operations to return to profitability. In a traditional Chapter 11 case, the debtor will go through a period of consolidation and will leave bankruptcy with a reorganized business and a reduced debt load. However, some entities have gone through a "liquidation Chapter 11" under which the company is wound down.

Additionally, in 2020, the Bankruptcy Code was amended to grant small businesses the option of filing for bankruptcy under Subchapter V of Chapter 11 of the Bankruptcy Code. Subchapter V allows small businesses that meet certain criteria to repay a portion of their debts through a court-approved repayment plan and discharge unsecured debts. To qualify under Subchapter V, a business must be active and engaged in business activities, must have debts that do not exceed $2.75 million, must not owe debt to company insiders, and must have at least 50% of their debt arising from business activities. The benefits of a Subchapter V bankruptcy include: (1) the small business operator can continue to operate the business; (2) the creditors do not need to approve the plan; (3) only the small business, and not the creditors, can propose the plan; (4) no detailed disclosures are required; and (5) a special trustee will be appointed to oversee the repayment plan and monitor operations.

What happens once a bankruptcy petition is filed?

Once a debtor files a bankruptcy petition, it receives certain protections immediately, such as the stay of all litigation and the termination of collection activity. (More on the automatic stay is found above in Section 2). A debtor also has numerous disclosure obligations: it must file a list of creditors, a schedule of assets and liabilities, a schedule of current income and current expenditures, a statement of financial affairs, and other disclosures.

What is the bankruptcy estate?

When a bankruptcy proceeding is filed, all of the debtor's property and interests in property become the bankruptcy estate. In Chapter 7, this generally consists of all property as of the date the bankruptcy petition was filed; but in other chapters, it also includes interests in property and earnings acquired after the bankruptcy petition was filed. The bankruptcy estate is a broad concept, encompassing all legal and equitable interests of the debtor and anything that is the community property of the debtor and his/her spouse. 11 U.S.C. § 541; *see also* 11 U.S.C. §§ 1115, 1207, 1306. In addition to physical and tangible assets, property of the estate includes stock and stock options, legal claims (the right to file a lawsuit), inheritance rights, leases, licenses, patents, and trademarks. A debtor can except certain assets or property from the bankruptcy estate by way of an exemption. These exemptions, arising under the Bankruptcy Code or state law, protect property from sale for the benefit of creditors. To invoke an exemption, a debtor must claim the appropriate federal or state bankruptcy exemption when filing the bankruptcy petition.

Other Helpful Resources

Bankruptcy Basics (U.S. District Court)

ABI Bankruptcy 101

Collier on Bankruptcy, Sixteenth Edition

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Note: This guide is only intended to provide background information regarding bankruptcy issues. It is not intended as legal advice and should not be construed as such. If you or your client are facing a specific bankruptcy issue, please consult a bankruptcy attorney.

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