GLOSSARY OF BANKRUPTCY AND COMMERCIAL LAW TERMS

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OVERVIEW OF BANKRUPTCY LAW

Bankruptcy Code - a body of federal law enacted by Congress as the Bankruptcy Reform Act of 1978, designed to relieve financially distressed individuals and business entities. The Code is divided into chapters, some applying to the administration of cases and some providing particular forms of bankruptcy relief.

Chapter 7 - <u>Liquidation</u>. In a chapter 7 case, a court-appointed or creditor-elected trustee collects or sells the debtor's *nonexempt property* (see *exemptions*) and distributes the proceeds to creditors. By giving up all nonexempt property, the debtor anticipates receiving a *discharge*, which is a release from liability for pre-bankruptcy debts.

Chapter 9 - <u>Municipal Debt Adjustment</u>. Available to cities, counties, and school and water districts. chapter 9 provisions are similar to those of chapter 11, though the municipal debtor enjoys greater autonomy and flexibility.

Chapter 11 - <u>Business Reorganization</u>. In a chapter 11 case (available to individuals and business entities), the debtor (termed a *debtor in possession*) usually retains control and management of its assets while it formulates and proposes to its creditors a reorganization plan. The plan must be submitted to creditors for acceptance and confirmed by the bankruptcy court. The philosophy underlying chapter 11 is that staying in business and generating income benefits the economy and offers creditors a better chance for repayment.

Chapter 12 - <u>Family Farm Debt Adjustment</u>. Chapter 12 permits family farmers with debts under a certain amount to continue farming while proposing a debt adjustment plan. The plan is not voted on by creditors and becomes effective only if confirmed by the bankruptcy court.

Chapter 13 - <u>Consumer Debt Adjustment</u>. Available only to individuals, chapter 13 permits consumers to obtain a discharge of prebankruptcy debts by making payments over a 3-5 year period to a trustee who disburses the funds to creditors.

Chapter 15 - <u>Ancillary and Other Cross-Border Cases</u>. Added in 2005, chapter 15 provides mechanisms for dealing with insolvency cases involving more than one country. It is the U.S. domestic adoption of the Model Law on Cross-Border Insolvency promulgated by the UN Commission on International Trade Law ("UNCITRAL") and it replaced section 304 of the Bankruptcy Code.

Involuntary Bankruptcy - Under the Bankruptcy Code, creditors may force a debtor (except a farmer) into bankruptcy by filing an involuntary chapter 7 or 11 bankruptcy petition against the debtor. Usually, three or more creditors holding at least $13,475 of unsecured debt are required to jointly file the petition, which is generally granted if the debtor is not paying its debts as they come due. (**Note**: Cases under chapters 12 and 13 are strictly voluntary.)

RELATED BANKRUPTCY & COMMERCIAL LAW TERMS

Automatic Stay - an injunction that arises automatically upon the filing of any bankruptcy case. It prevents creditors from enforcing debts against the debtor or its property or continuing litigation against the debtor. The automatic stay permits orderly administration of the debtor's property. It may be terminated only by an order of the bankruptcy court.

Bankruptcy Courts - adjuncts of federal district courts. The constitutional power to hear and decide bankruptcy matters is vested in the federal district courts, but most bankruptcy cases are automatically referred to bankruptcy courts.

Bankruptcy Judge - hears matters arising in bankruptcy cases in bankruptcy court. Bankruptcy judges have limited powers because they lack the protections given other federal court judges by Article III of the United States Constitution. Nevertheless, a final order of a bankruptcy judge is a binding federal order.

Cramdown - a bankruptcy court's enforcement of a reorganization plan despite the objections of some creditors.

Creditor - a person to whom the debtor is indebted.

Creditors' Committee - a group of unsecured creditors appointed in a chapter 11 case by the United States Trustee to represent the interests of the debtor's unsecured creditors.

Debtor – under the Bankruptcy Code, a person or business entity that commences a bankruptcy case or against whom an involuntary case in commenced; outside of bankruptcy, one who owes a debt.

Debtor's Estate - all the debtor's legal or equitable interests in property when the bankruptcy petition is filed, and certain property rights acquired thereafter.

Disclosure Statement - the document used to solicit acceptances of a chapter 11 plan of reorganization. A disclosure statement must be approved by the bankruptcy court before it is distributed to creditors and shareholders to ensure that it contains adequate information to permit the recipient to make an informed judgment about the plan.

Equitable Subordination - a method by which the bankruptcy court subordinates a claim to other claims because the creditor's actions have harmed the estate or other claimants.

Executory Contract - an unperformed contract to which the debtor is a party, under which failure to perform by either party constitutes a material breach of the contract, excusing the other party from further performance. Under the Bankruptcy Code, the debtor must assume or reject (*breach*) an executory contract within a specified period of time.

Exemptions - allowances under the Bankruptcy Code that permit an individual debtor to legally shelter certain property (e.g., a home, car, life insurance policy, etc.) from the bankruptcy or debt collection process. Exemptions allow the debtor to retain property essential to financial survival. By definition, all property not defined as exempt is *non-exempt* and is available to pay creditors.

Fraudulent Conveyance or **Transfer** - a transfer of property by the debtor made in an attempt to hinder, delay or defraud creditors; or a transfer for which the debtor -- who is insolvent, becomes insolvent as a result thereof, or has unreasonably small capital -- receives less than reasonably equivalent value. The bankruptcy trustee may invalidate the transaction. Fraudulent transfer actions can also be brought under state law.

Lien - a charge against or interest in property to secure payment of a debt or performance of an obligation.

Perfection - the act of ensuring (in accordance with steps outlined in the Uniform Commercial Code) that a security interest achieves and maintains a priority position with regard to other security interests or liens. Recording (filing with the secretary of state or county clerk) a financing statement that describes the collateral or taking possession of the collateral are two methods of perfection.

Plan of Reorganization - the document in a chapter 11 case that sets forth the manner in which the debtor's business will be restructured. The plan describes how creditors will be paid and shareholders treated. Creditors vote on the plan, which is approved by the bankruptcy court only if various conditions are met.

Preference - a transfer of a debtor's property prior to (usually within 90 days) the filing of the bankruptcy petition may be invalidated if it permits a creditor to receive a greater recovery than others of the same category (e.g., priority, unsecured, etc.). Preference law is designed to ensure equality of payment among creditors.

Priority - the Bankruptcy Code's statutory ranking of unsecured claims that determines the order in which unsecured claims will be paid if there is not enough money to pay all unsecured claims in full.

Proof of Claim - a document filed by or on behalf of a creditor with the bankruptcy court setting forth the creditor's claim against the debtor's estate.

Security Interest - a voluntary lien on personal property that a debtor grants to a creditor (the *secured party*) pursuant to the Uniform Commercial Code that allows the secured party to satisfy the debt by foreclosing on the collateral.

Trustee - a person appointed by the United States Trustee to perform certain duties in a bankruptcy case. In a chapter 7 case, the trustee sells the debtor's assets and makes distribution to creditors. In chapters 12 and 13 cases, the trustee ensures that the debtor makes payments and then distributes the payments to creditors. In a chapter 11 case, a trustee is appointed only in unusual circumstances to take over operation of the debtor's business. Unlike the United States Trustee, the bankruptcy trustee is not a federal government employee.

Uniform Commercial Code (UCC) - a largely uniform set of laws adopted by all 50 states regarding commercial transactions such as sales of goods, letters of credit, and secured transactions.

United States Trustee - a governmental official appointed by the United States Attorney General who oversees the administration of bankruptcy cases.

Workout - an out-of-court negotiating process with the goal of permanently realigning a debtor's financial obligations. Usually, all interested parties (e.g., the debtor, secured creditors, unsecured creditors) are involved in the workout.