REES, BROOME & DIAZ, P.C.

October 2005

Bankruptcy Reform: Areas of Interest to Community Associations

By: Lella Amiss E. Pape

I. A LESS DEBTOR FRIENDLY CODE (?)

The "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005," known as the Bankruptcy Reform Act ("Act"), the first major revision of the federal bankruptcy laws since 1978, took effect on October 17, 2005. The Supreme Court summarized the intent of modern bankruptcy law, including our current laws, when it said that the federal bankruptcy laws are intended to give debtors a "fresh start," "a new opportunity in life, unhampered by the pressure and discouragement of pre-existing debt."

It is fair to say that in recent times bankruptcy laws favored debtors and posed a potential burden to creditors. The legislative changes implemented by Congress under the recently adopted Act are intended to address and prevent prior debtor abuses of the bankruptcy process.

One of the most important changes to the federal bankruptcy laws set forth in the Act requires debtors to pre-qualify in order to file a petition for relief from their creditors in the federal bankruptcy courts. Debtors cannot file a Chapter 7, 13, or 11 petition for relief until they have received an individual or group "briefing," which includes the preparation of a budget analysis, within 180 days prior to the date the debtor's bankruptcy petition is filed with the court. Also, under the Act, each debtor must include with their petition a debt repayment plan that reduces the principal owed to the creditor and that reduces or eliminates any interest payments owed to the creditor.

Community associations, which are typically creditors in any bankruptcy proceeding, are strongly encouraged to work with debtors to negotiate voluntary repayment plans. Specifically, debtors are required to have attempted to negotiate a repayment plan with a creditor at least 60 days prior to filing any bankruptcy petition.

If the creditor does not agree to the prepayment plan, and the proposed plan provided for payment of at least 60 percent of the debt over a period not longer than the original debt (for associations, this period is twelve months or less), the debtor can petition the Court to reduce, by not more than 20 percent, any unsecured consumer debt claim filed by the same creditor against the debtor. (Because of the difficulty in proving unreasonable refusal to negotiate a repayment plan, it seems doubtful that many claims will be reduced under this section. § 502(k)).

Additionally, all Ch. 7 and Ch. 13 debtors must complete a financial management course

approved by the Court before they are eligible to receive a discharge of their debts. § 727(a) (1); § 1328(g) and (h).

II. CONTACT FROM A CREDIT COUNSELOR AS A FOREWARNING OF BANKRUPTCY FILING:

Under the new bankruptcy laws, debtors are required to complete a credit counseling program within 6 months prior to seeking bankruptcy relief. It is likely that this counseling requirement may prompt some debtors to attempt to establish some kind of payment plan with their creditors. These payment plans may be negotiated through the credit counseling agency, and as a result, our community association clients may begin receiving notices from credit counseling agencies on behalf of a debtor who owes assessments to the association. If your association receives any such notices, we advise our community association clients to discuss referring the delinquent account to our office for collection (if you haven't already done so) to attempt to have a lien recorded against the property. Once recorded in accordance with your association's governing documents, the lien will ensure that the association's claim for assessments, costs and fees is recorded as a secured claim against the lot or unit.

III. NOTICE FROM ASSOCIATION IS CRITICAL

The new bankruptcy laws have attempted to resolve a disagreement in the Courts as to when a debtor has failed to provide proper notice of their bankruptcy petition to a creditor. The debtor is now required to provide notice to the creditor:

- At the address provided by the creditor in the last two communications received by the debtor within the 90 days before filing.

- If the debtor fails to send notice of his or her bankruptcy to the debtor at that address, notice to the creditor will be deemed ineffective.

IV. ABUSE PROHIBITION IS NOT ABUSE PREVENTION

It is important to remember that the new Code changes make it harder for a debtor to abuse the bankruptcy relief remedy, but these legislative changes will not prevent all abuse of the federal bankruptcy laws. The new bankruptcy laws now make it more difficult for debtors to: (1) obtain a complete discharge of their debts under a Chapter 7 bankruptcy petition; and (2) stall creditor action by repeatedly filing for bankruptcy.

Under a Chapter 7 bankruptcy, a debtor may petition for a complete discharge of all unsecured debt; however, prior to the discharge the debtor is now required to meet a "means test" to determine whether or not the debtor qualifies for a complete discharge of his or her debts. This means test establishes a financial threshold for a debtor to be eligible for a complete discharge of their unsecured debt; however, if the debtor's monthly net income exceeds the financial threshold established by the Court, the Chapter 7 proceeding will be dismissed, and/or the debtor must convert their Chapter 7 petition to a Chapter 13 petition

Furthermore, if the debtor files for bankruptcy and had a prior bankruptcy dismissed within the previous year, the subsequent filing is

"presumed" to be in bad faith. As a result, the debtor must demonstrate to the Court that he or she should be allowed to proceed with their newly filed bankruptcy petition.

As many of you are aware, once a bankruptcy petition is filed, the bankruptcy Court imposes the 'Automatic Stay', which prevents a creditor from taking certain legal actions to obtain the money or property of the debtor. The new legislative changes codified in the Act limit the impact, and in some cases eliminate, this Automatic Stay.

For instance, if the debtor files a subsequent bankruptcy petition within a specified period, the Automatic Stay will terminate within 30 days unless the debtor takes court action to reinstate the Automatic Stay.

Unless there is clear and convincing evidence to the contrary, if the debtor had two or more pending bankruptcy cases in the preceding year, a new bankruptcy case filed by any debtor will not create an Automatic Stay. If there is no Automatic Stay entered for the subsequent bankruptcy petition the debtor has no protection from its creditors.

The purpose of this legislative change is to make it difficult for debtor to refile for bankruptcy relief within a year after dismissal of a prior filing. The new code changes also affect:

- Automatic Stay and Real Property – If the court finds that a Debtor filed a petition to delay, hinder, and defraud creditors through a scheme to transfer real property without the consent of a secured creditor or court approval, or through filing multiple bankruptcy cases affecting the same real property, the Court may eliminate the automatic stay imposed on creditors in any case filed by the Debtor over the next 2 years.

- No More Ch. 13 "Super-discharge" – Under current law, a Ch. 13 discharge often covered debts that were not dischargeable in a Ch. 7 case – that situation has changed. Under the Act, Chapter 13 discharge does not discharge claims resulting from:

    - Debts that were neither properly listed nor scheduled in the petition to permit timely filing of a proof of claim, (and in the case of claims regarding luxury goods, fraud by a fiduciary, willful injury, and lack of sufficient time to challenge discharge ability),

    - Unless the creditor had notice or actual knowledge of the case so as to permit a timely filed proof of claim.

The most important aspect of the new burdens imposed by the legislative changes adopted in the Act is the requirement that any notice provided by a creditor to a debtor must be a comprehensive notice. In most cases, a notice from a creditor would be considered comprehensive if it includes, at a minimum, the full name of the association, its current mailing address, an association contact person and the debtor's account designations, if any. The contact information used in the Association's comprehensive notice must then be used by the debtor to serve notice of their bankruptcy petition upon the association.

Also, our community association clients should promptly contact any of our community

association attorneys when they receive a request for a payment agreement from a credit counseling agency. Thereafter, we can initiate action to prepare and record a lien against the title of the debtor's unit or lot in an attempt to ensure that the association's assessment claim is preserved if the debtor later elects to file for bankruptcy relief.

The Bankruptcy Court is assisting the creditors by setting up a data base where the creditor can designate a single point of contact to receive electronic bankruptcy court notices in that jurisdiction from debtors. Since the bankruptcy courts in our area use electronic filing almost exclusively, we strongly suggest that our clients consider appointing our office as the designated association representatives for the receipt of any electronic notices issued by the bankruptcy court concerning your association's delinquent owners.

If you have questions concerning any of the issues outlined in this memorandum, please contact Ami Pape or any of our Community Association Attorneys at 703-790-1911.

These materials contain general legal information about federal bankruptcy procedures and Community Associations. These materials are provided for educational purposes only. Rees, Broome & Diaz, P.C. is providing these materials with the understanding that neither the law firm nor the attorneys providing the information are engaged in the rendering of legal services for the recipient.