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Bankruptcy Update
by
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BANKRUPTCY: WHAT IS IT?
Title 11 of the U. S. Code

Article 1, Section 8 of the U.S. Constitution authorizes Congress to enact uniform laws on the subject of bankruptcy throughout the United States.

As a matter of policy, we believe in second chances. People or entities that are in financial difficulties are given an opportunity to reorganize their business affairs or liquidate their assets in an orderly manner to satisfy their creditors. And afterwards, there is a fresh start, whether the debtor is General Motors or a couple.

Title 11 of the U.S. Code is that enactment.

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BANKRUPTCY TALK
The "Chapters" of the Code

The Bankruptcy Code is divided into a series of chapters. Different Chapters deal with different types of bankruptcy.

When referring to a bankruptcy case, it may be cited as a Chapter 7 bankruptcy or other Chapter. The Chapter defines the type of bankruptcy you are dealing with and the rules and procedures that govern that type of bankruptcy.

Who controls property and limitations on their actions depends on the Chapter under which the bankruptcy is proceeding. It is also possible for a bankruptcy originally filed as a "reorganization" to convert to a "liquidation".

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BANKRUPTCY TALK
The "Debtor" and the "Creditors"

The "Debtor" is the party that has filed bankruptcy. The debtor can be an individual, a married couple, a partnership or a corporation.

The "Creditors" are the parties that the debtor owes money to or that claim the debtor owes them money.

Creditors can be "secured" creditors, meaning that they have a security interest recognized by law in some property of the debtor, such as a recorded deed of trust or lien, or a lien on a vehicle or manufactured home title.

Creditors can be "unsecured" creditors, meaning they are owed money, but have no security interests in the debtor's property.

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BANKRUPTCY TALK
The "exemptions" and the "estate"

The various Chapters of the Bankruptcy Code allow the individuals to claim certain property as exempt so that the debtors can continue to have a place to live and to pursue an occupation.

There are Federal Exemptions and State exemptions.

The most important state exemption for us is the Texas homestead exemption; 10 acres urban, 100 acres rural for a single person, and 200 acres rural for a married couple or the head of a household.

The estate is all of the property of the debtor, which is identified on the Schedules of the bankruptcy petition.

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THE DIFFERENT CHAPTERS
Chapter 7

Chapter 7 of the Bankruptcy Code involves liquidation of the non-exempt assets of the debtor.

The debtor's non-exempt assets are sold off to pay the claims of the creditors by a court appointed trustee.

This continues to be the most common form of bankruptcy for individuals.

CHAPTER 9: Reorganization for Municipalities

If you ever encounter this, give us a call.

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THE DIFFERENT CHAPTERS
Chapter 11

Chapter 11 allows an individual, corporation or partnership to retain some of their assets and to use income to pay off some existing creditors. The creditors may actually receive little or none of what they are owed.

The debtor must submit and have approved by the bankruptcy court a "Plan of Reorganization" that categorizes the creditors into different classes and explains how each class will be treated.

The plan can provide for payments for a period of up to 5 years. On successful completion of the plan, the debtors are given a discharge from their debts.

Chapter 11 bankruptcy by individuals is rare, it is used principally by businesses.

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THE DIFFERENT CHAPTERS
Chapter 12

Chapter 12 is another reorganization chapter, but is limited to family farmers and fishermen. The debtors must receive at least 80% of their income from farming or fishing.

The debtor must submit and have approved by the bankruptcy court a "Plan of Reorganization" that categorizes the creditors into different classes and explains how each class will be treated.

The plan can provide for payments for a period of up to 5 years. On successful completion of the plan, the debtors are given a discharge from their debts.

Areas with extensive farming see Chapter 12 bankruptcies. The exemptions in a Chapter 12 bankruptcy are more extensive than in Chapters 7 and 13. But in 2009 there were only 367 bankruptcy filings under Chapter 12.

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THE DIFFERENT CHAPTERS
Chapter 13

Chapter 13 is the reorganization chapter for individuals with regular income. The debtor is eligible for Chapter 13 if their unsecured debts are less than \$360,475 and their secured debts are less than \$1,081,400. These dollar limitations are subject to periodic adjustment based on the consumer price index.

The debtor must submit and have approved by the bankruptcy court a "Plan of Reorganization" that categorizes the creditors into different classes and explains how each class will be treated.

The plan can provide for payments for a period of up to 5 years. On successful completion of the plan, the debtors are given a discharge from their debts.

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THE AUTOMATIC STAY

The moment that the debtor files their bankruptcy petition with the Bankruptcy Court, all actions by creditors seeking to collect on their debts are "stayed" or stopped.

This includes lawsuits and foreclosure proceedings. A bankruptcy petition filed seconds before a foreclosure takes place stops the foreclosure, though a sale to a third party may be honored.

The automatic stay continues in effect until the bankruptcy is closed, dismissed or the bankruptcy court enters an order lifting the stay.

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WHO IS IN CHARGE?

In a Chapter 7 proceeding, the court appointed Trustee is in charge of the estate.

However, 30 days after the meeting of the creditors has concluded, if there are no objections to the debtor's claims of exemption, property claimed as exempt is returned to the debtors control and is no longer part of the estate. Watch for creditors meetings that are continued, because the 30 days doesn't begin to run till the meeting is concluded.

The trustee retains control of the non-exempt property

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WHO IS IN CHARGE?

In a Chapter 11 proceeding the "debtor in possession" generally controls the estate after the confirmation of the plan. However, if a trustee has been appointed by the court, we must confirm that the court has placed no limitations on the debtors power to deal with the estate.

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WHO IS IN CHARGE?

In a Chapter 13 proceeding, although a trustee is appointed by the court, the debtor retains control of the estate once the plan has been approved by the court. But that control is subject to the terms of the plan itself.

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SALES DURING THE BANKRUPTCY

During a Chapter 7 proceeding, any sale prior to 30 days after the conclusion of the creditors' meeting must be done by the Trustee with a court order authorizing it.

Once 30 days has passed since the conclusion of the creditors' meeting without objections to the exemptions being made, the debtor can sell the exempt property without any court order.

Subsequent sales by the Trustee of non-exempt property require a court order authorizing them.

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SALES DURING THE BANKRUPTCY

During a Chapter 11 proceeding, any sale prior to confirmation of the plan of reorganization will require a court order.

For volume real estate sellers, such as builders, the bankruptcy court may enter an order allowing the debtor to continue sales in the ordinary course of business. This order may allow the sale to be free and clear of certain types of claims, such as a mechanic's and materialmen's lien claims.

Once the plan has been approved, and if the plan provides for the sale, the debtor can sell the property without further court order.

Any sales of real estate that are not provided for in the plan will require a separate court order authorizing them.

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SALES DURING THE BANKRUPTCY

During a Chapter 13 proceeding, any sale prior to confirmation of the plan of reorganization will require a court order.

Once the plan has been approved, and if the plan provides for the sale, the debtor can sell the property without further court order. The debtor can sell property claimed as exempt, the homestead, without further court order.

Any sales of non-exempt real estate that are not provided for in the plan will require a separate court order authorizing them.

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LOANS DURING BANKRUPTCY

In a Chapter 7 proceeding, 30 days after the conclusion of the creditors' meeting, the exempt property is no longer part of the estate and the debtor can use it as collateral for loans.

Unless specifically provided for in the plan, new loans in a Chapter 11 or 13 bankruptcy will require a court order authorizing them.

If an debtor in a Chapter 13 bankruptcy has sold their exempt property, and are proposing to buy a new one, a court order authorizing the new loan must be obtained since the new debt may prejudice the debtor's ability to make payments under the plan.

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SALES AFTER BANKRUPTCY

Sales after bankruptcy present some interesting problems:

- Does the owner/former debtor actually own the property and can they sell it?
- What has happened to the voluntary liens against the property?
- What has happened to the involuntary liens filed against the debtor?

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SALES AFTER BANKRUPTCY

Does the owner/former debtor actually own the property and can they sell it?

Property claimed as exempt has returned to the debtor's control and can be sold.

Property that was not claimed as exempt, but revealed on the Schedules of the Bankruptcy Petition has returned the debtors, but may not be free and clear of involuntary liens against the debtors.

Property that was not disclosed on the Schedules of the Bankruptcy Petition raises issues of fraud on the creditors and will require underwriter approval to insure.

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SALES AFTER BANKRUPTCY
 What has happened to the voluntary liens against the property?

Unless the voluntary liens were specifically dealt with in the bankruptcy and the lien avoided by court order, the liens are still against the property.

Occasionally we find disclosed property that wasn't dealt with in the bankruptcy. The Debtors thought the lender would take it back, since they stopped making payments, but the lender never did. Although the bankruptcy may have released the debtor's personal liability on the debt, the lien against the property remains and we require a release.

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SALES AFTER BANKRUPTCY
 What has happened to the involuntary liens filed against the debtor?

Federal tax liens are not discharged by filing bankruptcy. We require discharges from the IRS.

State tax liens can be discharged in bankruptcy if the State is scheduled as one of the creditors.

Abstracts of judgment can be discharged in bankruptcy, but whether we can rely on that is governed by Sections 52.041 to 52.043 of the Texas Property Code

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SALES AFTER BANKRUPTCY
 What has happened to the involuntary liens filed against the debtor?

Sec. 52.042. DISCHARGE AND CANCELLATION. (a) A judgment is discharged and any abstract of judgment or judgment lien is canceled and released without further action in any court and may not be enforced if:

- (1) the lien is against real property owned by the debtor before a petition for debtor relief was filed under federal bankruptcy law; and
- (2) the debt or obligation evidenced by the judgment is discharged in the bankruptcy.

(b) A judgment evidencing a debt or obligation discharged in bankruptcy does not have force or validity and may not be a lien on real property acquired by the debtor after the petition for debtor relief was filed.

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SALES AFTER BANKRUPTCY
 What has happened to the involuntary liens filed against the debtor?

Sec. 52.043. EXCEPTIONS TO DISCHARGE AND CANCELLATION. A judgment lien is not affected by this subchapter and may be enforced if the lien is against real property owned by the debtor before a petition for debtor relief was filed under federal bankruptcy law and:

- (1) the debt or obligation evidenced by the judgment is not discharged in bankruptcy; or
- (2) the property is not exempted in the bankruptcy and is abandoned during the bankruptcy.

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BANKRUPTCY
 Recent Cases

In re Hardyzak

- Deed from owners to Perkins
- Deed from Perkins back to owners
- Deed from owners to Trust, Perkins as Trustee
- Deed from Trust to New Horizons
- Deed of Trust executed by New Horizons

In a adversary proceeding to avoid the lien, the court held the bank had actual knowledge of the owners interest in the property, including drafting a "consent of beneficiaries" to be signed by the owners.

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BANKRUPTCY
 Recent Cases

In re Ritter

Debtors had a cattle and poultry business on two tracts. Both tracts were homestead. They conveyed one tract to a corporation and took out a loan with a bank. The bank helped create the corporation.

Despite the corporation being in title, the bank knew of the debtor's homestead rights and the lien was invalidated by the court.

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BANKRUPTCY
Recent Cases

In re Betcher

Debtors deeded their homestead to an irrevocable living trust before filing bankruptcy. The Trustee in the Chapter 7 proceeding objected the claimed exemption because the debtors no longer owned the property. The court found the debtors retained enough of a possessory interest for the homestead exemption to attach.

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- B. Attorneys email bar card number to Ken Wrider for CLE credit
- C. Next Texas TIPS Online June 17, 2010, "Regulatory Update, Solvency Legislation Implementation" by John Rothermel
- D. Questions/Comments? Email fred.schraub@stewart.com
- E. Visit www.stewarttexas.com for presentation materials within 5 business days of the webinar
