



## NAVIGATING THE BASICS OF BANKRUPTCY

With more and more homeowners filing bankruptcy every day, bankruptcy related issues have become an increasing concern for community associations. When delinquent owners file for bankruptcy, it can have a significant impact on an association's ability to collect its past due assessments. The increase in the number of bankruptcies over the past few years has been a source of frustration for many association boards and managers. In many cases, it can seem that owners are simply resorting to bankruptcy as a means of avoiding their debts, and some boards and managers have been threatened with bankruptcy by owners when the association attempts to collect on its assessments. The unfortunate fact is that bankruptcy has been, and will continue to be, a remedy afforded under the law to those qualified persons in need of financial relief.

Determining if a debtor qualifies for bankruptcy depends on the type of bankruptcy the debtor is attempting to file. The two most common forms of bankruptcy filings are Chapter 7 and Chapter 13. Bankruptcy courts have rules and computations that include a complete and thorough review of the debtor's assets and liabilities. These bankruptcy rules will ultimately determine if a debtor qualifies for bankruptcy, but these rules generally are lenient towards debtors.

### THE BASICS

Chapter 7 and Chapter 13 bankruptcies will be discussed separately below; however, the basic procedure is the same for each type of bankruptcy. In discussing either a Chapter 7 or a Chapter 13 bankruptcy, it will be useful to understand some of the common concepts:

**Petition.** The bankruptcy starts with a debtor filing a petition in the appropriate Federal Bankruptcy Court. In the petition, the debtor will designate what debts he or she intends the bankruptcy to cover. The filing date of the petition is a critical date to note, as all debts that have accrued up to the date of filing will be included in and covered by the bankruptcy petition. All debts that come due after the filing date are considered post-petition amounts, and the debtor generally continues to be obligated to pay these amounts as they become due. Pre-petition and post-petition amounts are treated differently under bankruptcy law and should be accounted for separately as a result. This often means maintaining two separate ledgers for an owner.

**Trustee.** When a bankruptcy petition is filed, the bankruptcy court will assign an independent and impartial case administrator, known as a trustee, to guide the bankruptcy petition through the bankruptcy court. The trustee will ultimately make decisions and recommendations that will determine whether a bankruptcy petition warrants consideration by the court.

**Automatic Stay.** Once a petition is filed, the bankruptcy court issues a stay on all collection activities against the debtor. This stay is issued by the court on behalf of the debtor, and is a mandate to creditors listed in the petition to immediately halt or otherwise discontinue all collection efforts. This stay precludes collection activity for **both** pre-petition and post-petition amounts. The automatic stay severely restricts the collection

3520 Piedmont Rd  
Suite 415  
Atlanta, GA 30305  
P:404.350.1192  
F:404.350.1193

Visit us at:  
[condoandhoalaw.com](http://condoandhoalaw.com)

activities that an association can take after a debtor has filed for bankruptcy. This topic is discussed in more detail in the strategies section below.

**Relief from Stay.** If the debtor fails to pay post-petition assessments, it is possible to obtain a relief from the stay by filing a Motion for Relief from Stay with the bankruptcy court through the association's attorney. It is important to note that the relief from the stay allows the association to file a lawsuit against the debtor for **post-petition** amounts only, and, during the bankruptcy, the relief from stay only permits the association to foreclose on its lien for these amounts. The association is not permitted to collect on that judgment through other collection actions, like garnishment, until the underlying bankruptcy case is resolved. It is also important to understand that the relief from stay does not allow an association to take any other collection efforts, such as suspension of privileges.

**Discharge or Dismissal.** A bankruptcy is resolved either when the petition is dismissed or the debt covered by the petition is discharged. The terms dismissed and discharged have very specific meanings in bankruptcy. When a bankruptcy is

**"The association is not permitted to collect on that judgment through other collection actions, like garnishment, until the underlying bankruptcy case is resolved."**

dismissed, the debtor's bankruptcy petition does not go through. This means that an association can go forward with its collection actions on both pre-petition and post-petition debts. When a bankruptcy debt is discharged, the pre-petition amounts are cancelled or wiped out, and the debtor is no longer responsible for those pre-petition amounts. The association generally must write off the discharged amounts as bad or uncollectable debt. It is important to note that even with a discharge, in most cases, the debtor remains responsible for all post-petition amounts until the property is sold or foreclosed, regardless of the type of bankruptcy filed by the debtor. Also, as discussed more below, the owner's discharge may not eliminate the association's lien on the property, leaving the association another possible source for collection.

**Surrendering or Retaining the Property.** Another concern that associations encounter with bankruptcy filings is whether the debtor intends to retain or

surrender the property following the resolution of the bankruptcy. The debtor will reveal his or her intention by stating in the bankruptcy case whether the property will be retained or surrendered. There has been some confusion as to the effect of a debtor's stated intention to surrender the property. Georgia law is clear that until there is a transfer of property, the debtor remains responsible for the post-petition assessments. This is the case even in situations where the debtor intends to surrender the property. This is discussed in further detail in the strategies section that follows below.

## **TYPES OF BANKRUPTCY**

**Chapter 7 Bankruptcy.** Chapter 7 bankruptcy is the most common form of bankruptcy, and is often referred to as "liquidation" because all non-exempt property of the debtor is sold to pay the debtor's creditors. In a great majority of cases, the debtor has no assets that qualify for sale, and, therefore, there will be no proceeds to distribute or pay to creditors.

Under the Chapter 7 bankruptcy, the debtor identifies his or her creditors in the petition, and the bankruptcy trustee notifies these creditors of the debtor's bankruptcy filing.

Once the petition is filed, the trustee will make a determination as to whether there are assets that qualify for liquidation and set a date for a hearing for the list of creditors. If there are no assets, then the bankruptcy trustee will fast track the bankruptcy and will not ask the listed creditors to file a proof of claim. A proof of claim is a pleading filed by the creditor that details the amount owed by the debtor. If the bankruptcy trustee determines that there are no assets to sell, and, thus, no proceeds to distribute to listed creditors, there is no practical reason for the association's attorney to file a proof of claim.

If there are no assets to sell or proceeds to distribute, a Chapter 7 bankruptcy generally takes between four to six months to complete. The bankruptcy court will grant a discharge of the individual's debt in most cases where the bankruptcy trustee determines that there are no assets to sell. If the trustee determines that there are assets to distribute, each creditor will be asked to file a proof of claim detailing the amounts

owed by the debtor. In this case, the association should expect to see some distribution of payment within three to six months from the filing of the proof of claim, but it is rare that any payment to creditors is made in a Chapter 7 bankruptcy.

**“Chapter 13 bankruptcy is often referred to as a “wage earner’s” bankruptcy, and is typically filed by debtors that have a regular source of income. In this type of bankruptcy, the debtor will prepare a repayment plan to creditors and submit to the bankruptcy court.”**

In some cases, the bankruptcy court will dismiss the debtor’s Chapter 7 petition. This is typically a result of the debtor missing a filing deadline or providing inaccurate asset or liability information to the court. As soon as the petition is dismissed, the bankruptcy stay is released, and the association can continue with its collection efforts as if the bankruptcy had not been filed. Chapter 13 Bankruptcy. Chapter 13 bankruptcy is often referred to as a “wage earner’s” bankruptcy, and is typically filed by debtors that have a regular source of income. In this type of bankruptcy, the debtor will prepare a repayment plan to creditors and submit to the bankruptcy court. The repayment plan will propose either a three-year or five-year repayment schedule, and must be approved by the court.

Again, the process begins when the debtor files a petition. Within 30 to 45 days from the filing of the petition, the court will set a Confirmation Hearing where the debtor’s proposed payment plan will be confirmed or rejected. Unlike a Chapter 7 bankruptcy, the association’s attorney should file a Proof of Claim with the court if significant sums are owned to the association. This is important because in a Chapter 13 bankruptcy, the association will receive at least partial, but often full, repayment of the amounts detailed in the Proof of Claim.

As part of any repayment plan, a debtor must make payments under the plan as scheduled, and must make timely payment of ongoing, post-petition assessments. If the debtor fails to make post-petition amounts, the

association can file a Motion for Relief from Stay as discussed above to file suit for post-petition amounts. Motions for Relief from Stay are more common under Chapter 13 bankruptcies given the length of time the repayment plan can take, and the statute of limitations that governs when a suit must be filed on aging, past-due assessments.

Assuming that the repayment plan is confirmed by the court, disbursements or payments typically will begin three to four months after confirmation. Disbursements will continue until the repayment plan is completed.

## **COMMON ISSUES WITH BANKRUPTCIES AND ASSOCIATIONS**

Automatic Stay. As mentioned above, an automatic stay is issued by the bankruptcy court as soon as the bankruptcy petition is filed. The bankruptcy stay is a very broad limitation on all creditors and prevents almost all collection activities against the debtor. The following actions are considered collection activities that would violate the automatic stay:

- sending collection letters
- initiating collection phone calls
- filing or continuing to pursue a lawsuit
- filing or continuing to pursue a wage and/or bank garnishment
- initiating or continuing foreclosure proceedings
- initiating or continuing utility suspension
- initiating or continuing parking suspension
- initiating or continuing services suspension
- initiating or continuing voting suspension.

These collection activities are not permitted while the bankruptcy is still active. As you can see, this greatly impacts how an association can recover the past due assessments owed by the debtor. However, associations still have some remedies available, despite the automatic stay.

A debtor remains responsible for all assessments that accrue after the filing of the bankruptcy petition. Associations are entitled to a partial relief of the automatic stay if the debtor does not pay these amounts. If the Motion for Relief from Stay is granted by the bankruptcy court, the association then could file a lawsuit for the post-petition assessments. This allows the association to get a judgment in place as quickly as possible for all post-petition amounts, while the bankruptcy is still active. This will allow for garnishment and other post-judgment remedies as soon as the bankruptcy is either discharged or dismissed. In some cases, the Order for Relief also may allow the association to foreclose on its lien.

Debtor’s Intent to Surrender the Property. A particular source of confusion is how the association should treat a

**We Understand  
Community  
Associations.**

**Lazega & Johanson LLC**

is a law firm dedicated to representing community associations. We believe in building and maintaining long-lasting relationships with community associations and their managers by providing personal attention and superior services. We take pride in being a part of the team of experts you rely on to ensure the successful operation of your community.

**3520 Piedmont Rd  
Suite 415**

**Atlanta, GA 30305**

**P: 404.350.1192**

**F: 404.350.1193**

Visit us at:

[condoandhoalaw.com](http://condoandhoalaw.com)



debtor's account when that debtor states in his or her bankruptcy an intent to surrender the property. A debtor's stated intent to surrender the property is just that, a stated intention. The intent to surrender the property has no legally binding effect on the debtor's continued ownership of the property. As a result, the debtor generally will remain responsible for all past-due amounts owed until the property is transferred to another owner via foreclosure or sale. Associations should continue to maintain the debtor's account ledger in the same way it would any other bankruptcy account by maintaining separate ledgers for pre-petition and post-petition amounts until the bankruptcy case is resolved.

When the Association is Not Listed in the Debtor's Bankruptcy Petition. It sometimes happens that a debtor will file for bankruptcy and not list the association as a creditor. If the bankruptcy is still pending before the bankruptcy court, the association's attorney can file an appearance and a late proof of claim where appropriate, and no real harm to the association typically occurs. The question is how an association should react when it is not listed as a creditor and the debt has been discharged. The association's approach to this issue depends on the type of bankruptcy that is filed by the debtor.

If the debtor filed a Chapter 7 bankruptcy and has not listed the association as a creditor, and the debt has been discharged, generally there are limited options available to the association outside of pursuing the lien as discussed below. The reason that there are limited options available to the association in this case is that, even if the association is successful in opening the discharged bankruptcy for the purpose of filing its proof of claim, the debt included in the association's proof of claim will ultimately be included in the discharged debt leaving the association in no better position. Accordingly, this is not a viable option. The most cost-effective and efficient approach in this case to write off the amounts that would have been included in the petition as bad or uncollectable debt. Post-petition amounts would still be collectable, and would be pursued as such.

If the owner filed a Chapter 13 bankruptcy and has not listed the association as a creditor, and the debt has been discharged, the full debt is still owed and collectable. The debtor had the responsibility to list the association as a creditor. The fact that the association was not listed as a creditor results in the full debt being owed by the debtor.

The Lien Survives Bankruptcy. A bankruptcy discharge awards a qualifying debtor a fresh start on his or her personal obligation to repay the debts included in the bankruptcy petition. However, the bankruptcy discharge may not impact the continued validity of the association's lien on the debtor's property. This is an important distinction when an association or its agents are asked to provide a closing or refinance payoff on an account that previously had a bankruptcy discharge, subject to the applicable statutes of limitations. The requested payoff should include the total amount of the lien, including all fees and costs, without consideration of the bankruptcy discharge.

As you can see, bankruptcy provides a very large protection to debtors that qualify. As such, bankruptcies will continue to impact community associations and their ability to collect past-due assessments. Understanding some of the basic concepts, and of Chapter 7 and Chapter 13 bankruptcies, can help associations develop strategies on how best to navigate the sometimes confusing world of bankruptcy.

*The information contained on this site is provided for informational purposes as a service to the Internet community, and does not constitute legal advice. The use of this site or other communication with us does not create an attorney-client relationship. You should not act upon this information without seeking professional counsel. If you have confidential information do not provide it to us until we agree in writing to represent you for that matter. Unless you have received such a written agreement, we will not consider any correspondence, emails, or other communications you send us as confidential. Even if you receive such an agreement, you should note that email may be intercepted by others. You should therefore consider using other means to send sensitive or confidential information.*

*We try to provide quality information, but we make no claims, promises or guarantees about the accuracy, completeness, or adequacy of the information contained in or linked to this web site. Web links are provided to help you locate other Internet resources that may be of interest to you, and are not endorsements or approval of any information, products or services in the sites. In addition, laws and opinions are subject to change depending on changes in statutes or case law. As legal advice must be tailored to the specific circumstances of each case, and laws are constantly changing, nothing provided herein should be used as a substitute for the advice of competent counsel.*