

# 23

## CONSUMER RIGHTS AND A BANKRUPT BUSINESS

### § 23. 1. Introduction

This Consumer rights chapter describes your rights when a business which owes you money or services declares bankruptcy. It contains the following sections:

- § 23. 2. **What If A Bankrupt Business Owes You Money?**
- § 23. 3. **The Different Forms Of Bankruptcy**
- § 23. 4. **The Steps Of Bankruptcy**
- § 23. 5. **Consumer Creditors Of A Bankrupt Business**
- § 23. 6. **If A Shop Closes With Your Item Inside**
- § 23. 7. **Debts Not Discharged By Bankruptcy**
- § 23. 8. **Filing A Bankruptcy Claim**
- § 23. 9 **Proof Of Claim Form**

### § 23. 2. What If A Bankrupt Business Owes You Money?

At times consumers with a complaint against a business will discover that the business has “entered bankruptcy.” Does this mean the consumer creditor is out of luck? Not necessarily. This chapter describes the different types of bankruptcies and how consumer creditors with legitimate claims might still receive at least some of their money from the debtor business.

### § 23. 3. The Different Forms Of Bankruptcy

Relief for debtors under the Federal Bankruptcy Code is provided by 11 U.S.C. § 101 *et seq.* and can take a number of forms:

#### A. *Chapter 7 Bankruptcy*

Chapter 7 bankruptcy is also called a liquidation or straight bankruptcy. A debtor who files a Chapter 7 petition surrenders all non-exempt property, cash and assets to the U.S. Bankruptcy Court. The Court uses these assets, referred to as the debtor’s estate, to pay all allowed filed claims. Most Chapter 7 bankruptcies consist of no-asset estates—the debtor has no assets which exceed the secured claims of “secured” creditors. “Secured” creditors are those whose claims are based on liens on the debtor’s property. Usually, consumers will *not* be secured creditors of a bankrupt business. They can

only hope that the bankrupt business will have sufficient assets to satisfy not only secured creditors, but others as well.

### ***B. Chapter 11 Bankruptcy***

Businesses and individuals with high amounts of debt may file a Chapter 11 petition, thereby undertaking a business “reorganization.” Most Chapter 11 reorganization plans call for financial rehabilitation of the debtor over time. Some look more like Chapter 7 bankruptcies that sell property, pay taxes, pay secured creditors over time, and then cease doing business.

### ***C. Chapter 13 Bankruptcy***

Chapter 13 bankruptcy is a wage-earner plan. A debtor who files a Chapter 13 petition files a plan to pay his creditors over a period of up to 3 to 5 years. Secured creditors must be paid in full if the debtor intends to keep the property. Unsecured creditors (*e.g.*, consumer creditors of a retail business) are paid a percentage of their claims. Generally all receive the same percentage, which may be as low as 5% or as high as 100%. The wage-earner does not turn over any exempt assets to the Court. Rather he promises a portion of future income to the Court’s wage-earner plan.

## **§ 23. 4. The Steps Of Bankruptcy**

Here are the steps a debtor must take when filing for bankruptcy:

### ***A. Filing a Bankruptcy Petition***

Bankruptcy begins with the filing of a petition for an order for relief. The petition is filed with the Clerk of the United States Bankruptcy Court serving the area in which the debtor has lived for the past six months prior to filing or for a longer portion of the preceding six months than in any other jurisdiction.

In addition to the petition, the debtor must also file with the Clerk of the Bankruptcy Court a schedule of all debts and a list of all creditors, including their addresses and zip codes. The debtor must also file a detailed list of all property owned, including monies owed, property which may be inherited within six months, and insurance policies held. The bankrupt must also list all owned property claimed as being exempt under federal or state law. At least five days prior to the meeting of the creditors, the debtor must also prepare and file with the court a detailed statement of financial affairs.

When a petition is filed in bankruptcy, it is automatically referred to a Bankruptcy Judge. The Bankruptcy Judge is a federal judicial officer who specializes in bankruptcy matters. The Bankruptcy Judge presides over the bankruptcy proceeding and determines whether the petitioner is entitled to a discharge in bankruptcy. In Maine, there is a Judge located in Portland and one in Bangor. Cases are assigned geographically.

The act of the debtor in filing a petition in bankruptcy has far reaching significance. The petition serves as the application by the debtor for an order of relief (*i.e.*, for a discharge of debts without further action by the debtor). The petition operates as an automatic stay, applicable to all creditors, prohibiting further debt collection efforts. An estate is created by law consisting of any property and interests possessed by the debtor which are not exempt under applicable federal or state law. This estate is administered by a trustee for the benefit of creditors of the debtor.

### ***B. Appointment of a Bankruptcy Trustee***

As previously noted, a voluntary bankruptcy proceeding begins with the filing of a petition in the Bankruptcy Court by the debtor. Promptly after filing of the petition, a trustee will be appointed.

The trustee is the representative of the estate previously mentioned. It is the duty of the trustee to recover all assets of the debtor not exempt under law and to liquidate these assets for the benefit of creditors.

### ***C. Notice to Creditors***

Within a reasonable time after the petition is filed, normally at least 10 days but within 30 days, the Bankruptcy Court sends out a notice by mail to all creditors listed by the debtor of a meeting of creditors. The notice sets forth information concerning the meeting, the filing of claims and the selection of a trustee. The creditors are also told that if they have a valid objection to the debtor receiving a discharge, they must file a formal written objection within a specified number of days. The debtor must attend the scheduled meeting (normally in company with his attorney) and answer questions under oath. The debtor must be completely truthful and cooperative in answering questions concerning his financial status. The bankruptcy judge is not permitted to attend the meeting of creditors. A bankruptcy clerk or trustee presides at the meeting. Creditors have the right to elect a bankruptcy trustee of their choice. If creditors fail to elect a trustee, the interim trustee appointed by the court or by the U.S. Trustee, as the case may be, becomes the trustee.

The trustee, under the supervision of the bankruptcy clerk or U.S. Trustee, then takes possession of all property owned by the debtor which is not exempt; converts such property into money by selling it; and, on order of the bankruptcy judge, after costs of administration have been paid, distributes dividends to creditors to the extent money is available. The costs of administration average approximately 23% of the value of the bankruptcy estate.

### ***D. Creditor Claims***

Creditors must file their claims with the bankruptcy court within six months of the first date set for the first meeting of creditors or be barred from participating in any dividend which may be declared. There is a prescribed form for submitting proofs of claim which may be obtained from any stationery store which stocks legal forms or from the bankruptcy court. Or you can download the form from the Court's website at [www.meb.uscourts.gov](http://www.meb.uscourts.gov). If the creditor fails to file a claim, the trustee or a co-debtor may file a claim for the creditor.

In September, 1997, Sears, Roebuck and Co. entered into a Consent Decree with the State of Maine (and many other states) in which it agreed to cease the illegal bill collection practices it had been using after a Sears credit card customer had declared bankruptcy. For several years Sears had been threatening to repossess its bankrupt customers' goods, even though their debts had been discharged in bankruptcy. As a result of this Consent Decree, Sears agreed to repay almost 500 Maine consumers all the money it had illegally collected.

### ***E. Non-Dischargeable Debts***

Certain debts are *not* discharged in bankruptcy. Among these are: (1) taxes owed within three years of filing; (2) money, property, or services obtained by false pretenses or fraud; (3) debts not listed on the debtor's schedules unless creditors had notice or actual knowledge of filing; (4) debts for fraud, embezzlement, larceny or defalcation in a fiduciary capacity; (5) alimony or child support; (6) willful and malicious injury by the debtor to the person or property of another; (7) fine, penalty, or forfeiture payable to or for the benefit of a governmental unit, (8) any educational loan made, insured or funded by a government unit or nonprofit institution of higher education (with two exceptions, (a) such loan first became due before 5 years from the date the petition was filed, and (b) payment would impose an undue hardship on debtor and the debtor's dependents); or (9) a debt that was or could have been scheduled by the debtor in a prior proceeding.<sup>1</sup>

If a consumer creditor believes that the debt owed is not dischargeable, the creditor has the right to

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<sup>1</sup> 11 U.S.C. § 523.

petition the court to find that debt nondischargeable. If the bankruptcy court, after a hearing, finds this debt is not dischargeable, it will render a judgment in favor of the creditor which is legally enforceable against the debtor.

## **§ 23. 5. Consumer Creditors Of A Bankrupt Business**

All creditors “listed” by the debtor will be sent a notice entitled “Order for Meeting of Creditors.” See § 23.4 (C) above. A creditor should read the notice carefully. In Chapter 7 cases, the standard wording informs creditors that there are no assets expected and that filing a “proof of claim” form is not needed. If it later appears that there will be assets, the creditor receives another notice.

Often a bankrupt business will not list its *consumer* creditors with the Court. Therefore, consumer creditors should always file their own claims. Section 507(a)(6) of the Bankruptcy Code provides certain consumers with priority as creditors in bankruptcy proceedings. The consumer priority gives individual creditors priority for claims of up to \$900 for pre-bankruptcy *deposits* made in connection with purchase, lease or rental of property or services intended for personal, family or household use.

The safest route for a consumer creditor to follow upon learning of a business’ bankruptcy is to file the proof of claim form with copies of the bill and any other records of the transaction. Filing must be done with the standardized “*Proof of Claim*” form which can be downloaded from the court’s website at [www.meb.uscourts.gov](http://www.meb.uscourts.gov) and is available at minimal cost from stationery and office supply stores. See § 23.9 for a copy of this form. Much of the form will not apply to the creditor, who should follow directions and be sure to include the debtor’s name, case number, and the amount owed. You should also attach to the form any proof of payment, receipt for deposit or other written evidence of your claim.

The “Order for Meeting of Creditors” also informs the creditors of the automatic stay. Once a debtor files for relief in the U.S. Bankruptcy Court, virtually all actions to collect by creditors are stopped. The automatic stay provisions which protect the debtor and his property while the bankruptcy is pending are found at 11 U.S.C. § 362. This provision prohibits any action to collect, to obtain a judgment or lien, to enforce a judgment or to obtain property of or from the estate. A creditor may not sue, send bills, proceed with a court hearing or disclosure, file a lien or attachment or retake property or threaten to take any of these actions. Section 362 also interrupts the time period that runs for a foreclosure redemption or for the maturity of a lien. Violation by a creditor of 11 U.S.C. § 362 is punishable as contempt of court.

## **§ 23. 6. If A Shop Closes With Your Item Inside**

Unfortunately, a business will sometimes close while your item—an article of clothing waiting to be cleaned, an appliance needing repair, etc.—is still in the store. What can you do? Here are some ideas set forth by *The New York Times*.<sup>2</sup>

The first thing to do, experts say, is to try to find out who is responsible for the business: an individual, a corporation or partners. See if there is a sign on the door with the address of a new location or a phone number. Failing that, send a registered letter to the company at the address where the merchandise was left, requesting a return receipt showing to whom the letter was delivered, and at what address. In addition, ask in other stores in the neighborhood if anybody knows where those who ran the business have gone.

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<sup>2</sup> L. Sloane, “If A Shop Closes With Item Inside,” *The New York Times* 48 (Feb. 23, 1991).

“Contact the landlord,” said Barbara Gregg, director of the Office of Consumer Affairs in Montgomery County, MD. “The landlord doesn’t have a lien on the goods and you may be able to get your stuff.”

“If it’s a franchise, go to the franchiser,” said John A. Goodman, president of Technical Assistance Research Programs, a nonprofit consulting organization in Washington. “The franchiser has a very significant stake in his reputation and, in many cases, he can make you whole.”

Also, check with the nearest post office for a forwarding address. And, of course, a call or letter to the city or county consumer affairs agency, your state Attorney General’s office or local Better Business Bureau might prove fruitful.

The situation is somewhat different when you pay all or part of the cost of new merchandise that is still in a closed store. Many consumers have learned that the chances of retrieving any money or the item are small. Nonetheless, there are special protections in the Bankruptcy Code for consumers with claims of up to \$900, so you should inquire at the Federal Bankruptcy Court as to whether the store has gone bankrupt. If a bankruptcy filing is found, the court clerk will give you the docket number and the name of the judge hearing the case. You then have about six months from the date of filing to submit a written claim for merchandise left in the store. You use a legal form called Proof of Claim.

Attach to that form any proof of payment, receipt for deposit or other written evidence substantiating your claim and be prepared to wait for the merchandise.

“The best thing to do,” said Mr. Goodman of Technical Research Assistance Programs, “is to put down a minimum deposit and pay on a credit card, rather than cash.”

## **§ 23. 7. Debts Not Discharged By Bankruptcy**

Where an individual files for bankruptcy under Chapter 7 certain categories of debts are not dischargeable. Generally, those most relevant to cases involving consumers as creditors would be claims based on fraud or false pretenses, fraud as a fiduciary, embezzlement or larceny, alimony, maintenance or support, willful and malicious injury, or drunk driving.<sup>3</sup>

The Bankruptcy Code makes an important distinction between two categories of exceptions to discharge. The first category consists of debts which are excepted from the discharge regardless of whether the issue is raised during the bankruptcy case. Debts in this first category include alimony and support, certain debts incurred through drunk driving, and debts where a discharge was denied or waived in a prior bankruptcy. Consumers holding claims covered by these exceptions are free to assert them against the debtor after the bankruptcy, without the permission of the bankruptcy court.

The second category of exceptions consists of debts which are excluded from the discharge only if their nondischargeability is raised and determined during the bankruptcy case. The debts falling into this category are debts incurred by false pretenses or false financial statements, claims for breach of fiduciary duty, embezzlement, larceny, and claims for willful and malicious injuries. If your debt qualifies for this exception to the discharge rule, you will need a lawyer to file a complaint with the Court on your behalf.

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<sup>3</sup> See 9 NCLC Reports, Consumer Bankruptcy & Foreclosures Edition, 3 (July-August 1990). For this reason, an Attorney General enforcement action under the Maine Unfair Trade Practices Act (5 M.R.S.A. § 207) is exempt from the automatic “stay” imposed on efforts to collect a debt from a person who has filed for bankruptcy. See *In re Nelson*, 240 B.R. 802, 805-806 (Bkrcty. De. Me. 1999).

## § 23. 8. Filing a Bankruptcy Claim

If you discover that a business against which you have a claim has entered bankruptcy, call the Federal Bankruptcy Court for the area of the State in which the business is located. Tell the clerk's office your problem and that you want to file a claim. That office can help you fill out the necessary Proof of Claim form and will also tell you how to contact the trustee assigned to the bankruptcy. Attach to the Proof of Claim form any proof of payment (e.g., bill of sale, canceled checks). You are also free to go to the clerk's office and inspect the businesses' bankruptcy records. Of course, you can always seek the advice of a private attorney on how to best handle your claim. The addresses of the Maine Bankruptcy Courts are:

US Bankruptcy Court  
Clerk's Office  
537 Congress Street  
P.O. Box 17575  
Portland, Maine 04101  
207-780-3482 or  
1-800-650-7253

US Bankruptcy Court  
Clerk's Office  
202 Harlow Street  
PO Box 1109  
Bangor, Maine 04402-1109  
207-945-0348 or  
1-800-650-7253

Businesses located in Augusta and to the north will file for bankruptcy in the Bangor court. For more information go to the Court's website at [www.meb.uscourts.gov](http://www.meb.uscourts.gov).

## § 23. 9. Proof Of Claim Form

See next page for the Bankruptcy Proof of Claim form or go to the following web site:

[www.meb.uscourts.gov](http://www.meb.uscourts.gov)