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## Memorandum – Bankruptcy

Many community associations face the prospect of dealing with an HOA member who is delinquent on their assessments/dues and who files for bankruptcy protection. This memorandum is to provide general information and an overview of bankruptcy and its options in dealing with a bankruptcy filing.

Bankruptcy cases are filed and administered by the federal courts. Each district within Oklahoma maintains a separate bankruptcy court. These districts include the Western District of Oklahoma (Oklahoma City), Eastern District of Oklahoma (Muskogee), and the Northern District of Oklahoma (Tulsa).

1. **What is bankruptcy?** In its most basic form, bankruptcy is a creature of federal law allowing debtors to receive relief from the payment of debts as well as relief from the pursuit of those debts by creditors.

Many people have faced the prospect of having debt that exceeds their ability to service that debt for one reason or another. Maybe a debtor was laid off from a good paying job, or has been saddled with an unforeseen debt such as a medical emergency which greatly affects their ability to pay their debts. Bankruptcy law was adopted to provide debtors with a legal mechanism to avoid paying debts, to stop aggressive collection activity, and provide the debtor with a path to pay debts (or most of their debts) in an organized and structured way.

The bankruptcy code is contained within Title 11 to the United States Code (the “Code”) and is further organized and separated into chapters. Chapters 1, 3, and 5 contain the rules regarding the applicability of the Code, the administration of bankruptcy cases as well as the rules dealing with the administration of the bankrupt’s estate. Each of the other chapters apply to specific debtor structures or situations. An important aspect of the bankruptcy code is that debtors are given certain exemptions. In Oklahoma, the bankruptcy exemptions are defined by state law. For example, a person’s homestead (i.e., primary residence), sole means of transportation up to a certain value, and certain retirement accounts may not be sold or seized to pay debts in a bankruptcy case.

2. **Does bankruptcy eliminate a debtor’s debt to our HOA?** In a manner of speaking, yes, the debt is eliminated in that the debt cannot be collected after a completed bankruptcy. The technical answer is no – bankruptcy does not eliminate the debt. A completed bankruptcy resulting in a debtor’s discharge grants the debtor with a legal shield from the payment of the discharged debt. It is the law’s way of providing debtors a lawful order saying that the debtor is no longer obligated

to personally pay the debt. The discharge is also a bar for creditors that prevents collection of the discharged debt.

Many bankruptcy cases end with a disposition that does not result in a discharge of debt. For example, a bankruptcy can be dismissed because a debtor failed to make required plan payments, or a debtor may come into a windfall which may negate the debtor's original qualifications to file bankruptcy. In the event a bankruptcy case ends in action other than a discharge, then the pre-bankruptcy debt is not discharged and may again be pursued by the creditor using all remedies that were formerly available to the HOA client.

**3. What happens when a bankruptcy case is filed?** The very instant a bankruptcy case is filed, the protections of the Code and the bankruptcy Court is invoked by law. There is no need for a court order, or any other affirmative act to take place in order for the bankruptcy protection to go into effect.

In large part, 11 U.S.C. § 362 contains the most significant provision of the Code and is called the "automatic stay." In short, this section says that upon the filing of the case and notice to the creditor, any and all creditors must immediately cease all collection activity being taken against the debtor. It can be interpreted as telling creditors: you must immediately cease your efforts to collect from this debtor. If you wish to collect the debt, then you must pursue the debt within the confines of the bankruptcy case. In other words, the HOA must get in line with the other creditors, and the HOA may be paid through the administration of the bankruptcy case.

The Code defines the length of the automatic stay, and further limits what can and cannot take place during the stay's pendency. If a case was set for trial against a party in bankruptcy, it must now be postponed. If a lien was set to be filed against the debtor's home, it may not be filed. If the bankrupt debtor was scheduled to appear at a hearing on assets, it must be cancelled. Significant penalties can be assessed against any creditor that fails to recognize the automatic stay, or who willfully violates the stay. Furthermore, it is often difficult to determine whether the automatic stay is in effect, how long it lasts, and for what periods of debt the stay covers. **Therefore, HOAs and their managers should have procedures in place to determine whether a member is in bankruptcy, and it is strongly recommended for HOAs to immediately notify our office for assistance when dealing with bankruptcy and debt collection.**

**4. What types of bankruptcy will we face as a HOA?** For HOA purposes, Chapter 7 and Chapter 13 bankruptcies are most commonly encountered.

4.1. Chapter 7 bankruptcy is the liquidation chapter of the Code. In short, this chapter of bankruptcy results in the liquidation of the debtor's non-exempt assets. A debtor can only file a Chapter 7 by passing the *means test*. The *means test* is a creation of the Code to determine whether a debtor has the financial means to repay some or all of their debts. For example, a debtor with a good paying job is often disqualified from filing a Chapter 7 bankruptcy, because the debtor has the *means* by which to pay some or all of their debt.

4.2. Chapter 13 bankruptcy is commonly referred to as the "wage earner's bankruptcy." It is for individual debtors who have the *means* to pay some or all their debts. In these instances, the Code requires the debtor to file Chapter 13 bankruptcy, and then provides for the structured repayment of debts. The Code then supplies the rules, time-frame, priority, and other rules applicable to the repayment. For example, Chapter 13 may provide a debtor with the ability

to extend or modify the terms of repayment, or perhaps completely avoid the payment of certain types of debt.

5. **What if we don't know if a person is in bankruptcy? does a Chapter 13 bankruptcy do to our efforts to collect unpaid HOA assessments?** The fact that you, a manager, or any other person isn't aware of a debtor's bankruptcy is no excuse. Every collection action – demand letters, liens, court filings – must be preceded by a bankruptcy check. Not doing so takes a reckless and negligent chance at violating the debtor's rights, voiding the debt, and being subject to federal penalties.
6. **What does our HOA need to do when notified of a bankruptcy filing?** First and foremost, if the HOA has any ongoing effort to collect unpaid assessments from the bankrupt debtor both the HOA and its manager **MUST IMMEDIATELY STOP ALL COLLECTION EFFORTS**. Neither you nor your manager can hurry up and go get a lien filed once a debtor is in bankruptcy – doing so is a clear violation of federal law. To properly understand the creditor's rights in bankruptcy contact **WINTON LAW** to determine the implications of the bankruptcy filing and what can be done to collect. Our firm can guide the HOA through the process and help to position the HOA client to either collect from the bankruptcy estate, or otherwise position itself for future activity in the collection of future assessments.
7. **How much will this cost the HOA?** Entering a bankruptcy case is stepping into active litigation. Litigation always carries with it an element of uncertainty and risk. When entering a bankruptcy case, the primary risk to an HOA is usually that of additional costs and attorney fees associated with litigating the HOA's claim coupled with the risk that the HOA does not recover on its claim at all. No one, especially a non-attorney, can provide any assurance as to any result, which includes whether the HOA will recover the debt and the costs of doing so. Each case must be evaluated by an attorney on its own facts and merits.

**For more information on the Firm's billing practices associated with representing your HOA in a bankruptcy, foreclosure, and other collections matters, please contact us.**

We understand that navigating creditor's rights, whether in a bankruptcy context or otherwise is confusing. It is further complicated by the board's duty to manage the HOA's limited budget with reasonable discretion. We look forward to working with your HOA, and we are available to answer any questions you might have.

Sincerely,

**WINTON LAW**