

**Para 201- You & the Law**  
**Chapter 8- Consumer Bankruptcy**  
**Monday-11/2/09**

I. Alternative to Bankruptcy:

- A. Creditors may be willing to settle claim for smaller cash payment OR stretch out term of loan OR reduce size of payments
- B. Judgment- Proof debtor: you have so little \$\$ or assets you couldn't pay court judgment against you
- C. Discuss your situation with credit counselor
  - find at: <http://www.nfcc.org>
  - creditors may go for restructuring because they'll get more \$\$ than if you declare bankruptcy

II. Bankruptcy: legal process through which people and businesses can obtain fresh financial start when they are in such financial difficulty they can't repay their debts

- A. Process: file petition with Bankruptcy Court
  - (1) this remains on your credit record for 10 years
- B. Some of your assets will be exempt under federal and state laws
- C. Automatic stay issued on collection activity

III. Types of Bankruptcy

- A. Chapter 7: straight bankruptcy: involves surrendering most of your assets
- B. Chapter 13: wage -earner's bankruptcy: debtor proposes plan to repay all or portion of debt in installments under 3 to 5 year plan
- C. Chapter 11: for businesses that are restructuring while continuing operations
- D. Chapter 12: special type of bankruptcy for farmers

IV. Discharge from debts: once bankruptcy ends, most borrowers are discharged (no longer liable for) debts they incurred before filing bankruptcy petition (pre-petition debts)

(1) there are some categories of debt that are non-dischargeable:

- (a) tax liens
- (b) alimony
- (c) child support (including arrearages)
- (d) property settlement obligations from divorce
- (e) most student loans
- (f) fraudulent debts
- (g) criminal obligations like fines

(2) secured creditors have right to seize & sell collateral for loan (home/car); have more protection in bankruptcy than unsecured creditors

V. Chapter 7 Bankruptcy- see scenario on top of p. 323 of materials

A. To be eligible for Chap 7, you must earn less than the median income in your state

(1) if you earn more, you must pass a “means” test to determine eligibility: complex formula under IRS guidelines to determine if you have less than \$100 a month after subtracting food/rent/mortgage etc

(2) if you have over \$166 per month, you must file Chapter 13

B. Must undergo credit counseling within 180 days before filing for Chapter 7 or 13

--clerk of Bankruptcy Court has list of approved credit counseling agencies

C. Submit petition to Bankruptcy Court along with Statement of Financial Affairs and schedules that describe your financial history and list all your income, assets, & debts

(1) accessing credit report may help you complete these schedules

(2) assets pledged as collateral on loans are encumbered assets

(a) under-secured: \$1200 car securing \$3000 loan

(b) over-secured: \$65,000 FMV of home subject to \$30,000 mortgage

(3) creditor has right to take back collateral after having automatic stay lifted or after debtor discharged

(4) unencumbered assets: assets not subject to lien at all OR debtor’s equity in assets that are collateral for over-secured claims

(5) exempt assets: list on Schedule C: federal and state law defines which assets you can shield/protect this way

(a) in 10 states you can exempt assets either under federal or state law

(b) exemptions vary widely from state to state

\*\* See example on bottom of p. 327

\$ 65,000 FMV of home

(25,000) mortgage

40,000 equity

(34,900) maximum federal exemption for homestead

5,100 creditors could claim

\*\*Florida & Texas shield almost all value of homestead no matter the \$\$ amount

\*\* if homestead exemption in your state is lower (i.e. Georgia’s is \$5000), the lower exemption applies

- (6) married debtors must claim exemptions under the same law--federal or state
  - may be preferable if only one spouse has substantial debt for that spouse to file alone
- (7) homestead exemptions don't affect the right of the mortgage lender to foreclose on debtor's home
- (8) 85 % of Chapter 7 filings are "non-asset" filings: no assets of value left for unsecured creditors after exempt assets have been claimed & secured assets have been returned to creditors

- D. Debtor may redeem property (rare) or reaffirm debt if creditor willing
  - reaffirmation generally not good for debtor
  - usually must indicate intent to redeem or reaffirm within 15 days of filing
- E. Trustee can cancel any transfers you make for less than adequate consideration within one year prior to filing and recover the property for the bankrupt estate
  - could face federal criminal charges for fraudulent transfer
- F. Clerk notifies your creditors of your petition and trustee is appointed
  - you file homestead deed for exempt property
  - you attend first meeting of creditors where you'll answer Q's under oath
  - if you disagree with trustee's decision, you can protest to Bankruptcy Court which makes the final decision
- G. Trustee will assemble, liquidate, & distribute value of your nonexempt assets, if any
  - (1) trustee first distributes to secured creditors the value of collateral or collateral itself
  - (2) trustee pays unsecured priority claims (taxes, past-due alimony/child support)
  - (3) if any assets left, trustee pays general unsecured creditors on *pro rata* (proportionate) basis

--then court discharges debtor from remaining balances of any general unsecured debt

\*\* See website for official forms on p. 333

<http://www.uscourts.gov/bankruptcycourts.html>

\*\* See other websites on p. 333 and general summary on Chapter 7 on p. 334

#### VI. Chapter 13 Bankruptcy: see scenario on top of p. 335

- A. Allows individuals who have steady incomes to pay all or portion of their debts under protection & supervision of court
- B. Debtor files petition & proposed payment plan with court
- C. To be eligible, debtors must have less than \$290,525 in unsecured debts (such as credit cards) and less than \$871,550 in secured debts (such as home mortgage, car loans)
  - these amounts are subject to periodic adjustments and apply to married debtors too

D. Chapter 13 differs from Chapter 7 because debtor pays debts out of income, not assets  
--payment period runs from 3 to 5 years

E. Payment plan represents either:

- (1) full satisfaction of debts OR
- (2) all of debtor's disposable income for a 3 year period

--trustee verifies accuracy and reasonableness of payment plan

--creditors will have a chance to challenge it at hearing

--secured creditors can object to values debtor places on collateral and rate of interest  
debtor propose

--debtor must provide for payment in full of priority claims (taxes, family support obligations, most student loans)

F. Discharge is obtained after debtor has completed payments under the plan

--if debtor can't keep up with payments, could possibly get moratorium or modification of plan

--if debtor can't pay and does nothing, creditor or trustee can have case either converted to Chapter 7 or dismissed

VII. See comparison of Chapter 13 with Chapter 7 on pp. 341-343

--Most of the advantages lie with Chapter 13, but Chapter 7 may be preferable:

- (1) for those debtors with no nonexempt assets they wish to keep, no debts excepted from discharge, no co-signers of consumer loans
- (2) for those debtors who don't want to commit their disposable income to creditors 3 to 5 years
- (3) for those debtors ineligible for Chapter 13 because amount of debts exceeds limits
- (4) for those debtors who want this information off their credit record earlier (i.e. 10 years for Chapter 7 but 7 years after discharge after 3 to 5 years of payments in Chapter 13)

VIII. Protecting your Home

A. Under Chapter 7 if you have no equity and are in default, the creditor can foreclose even after your unsecured debts are discharged

B. Homestead exemption is the amount of debtor's home's value the law puts out of the reach of creditors

(1) the lower the exemption and the higher the debtor's equity, the better the chance trustee will take home to sell: see example on p. 344

(2) see example on p. 345

\$190,000 FMV of home

( 55,000) mortgage

135,000 equity

(30,000) homestead exemption

105,000 amount available for unsecured creditors

IX. Chapter 12- Farmer's Bankruptcy

- A. Allows family farmers with regular income to avoid foreclosure on farm by pledging part of future crops to pay off debts
- B. Must submit list of creditors, list of assets & liabilities, and Statement of Financial Affairs

\*\* See websites on p. 347

\*\* See comparison of Chapter 7 and Chapter 13 on last 2 pages of materials