

Overview of Bankruptcy

This is the inaugural column on the workings of consumer Bankruptcy. My hope is to present a pragmatic view of consumer bankruptcy practice, offering guidance on when bankruptcy may be appropriate, explaining what can be accomplished, and discussing the process of filing of a case.

Bankruptcy is codified in title 11 of the United States Code. This column will focus primarily on cases filed under chapter 7 and 13. Chapter 7 is available to all persons and entities except municipalities, while chapter 13 is only available to natural persons. The other chapters of the bankruptcy code include chapter 11 (providing for reorganization for natural persons as well as corporations), chapter 12 (for family farmers and fishermen), and chapter 9 (for municipalities). Although bankruptcy is governed by federal code, many issues are governed by the substantive law of the state within which the case is filed. Some of the most common examples of state law application include: exemptions (which property is protected from creditor claims); title law; real estate law; fraudulent conveyances; and marital law.

What does bankruptcy do? It is inaccurate and too simple to say that bankruptcy "gets rid of your debts." More accurately, bankruptcy requires that debts be paid to the extent the person's assets and income provide for repayment. Certainly, though, in the majority of consumer bankruptcies, many debts are discharged. An individual filing for bankruptcy is generally subject to means testing to measure their ability to repay their unsecured debts. Means testing can be avoided if less than fifty percent of their debts are non-consumer debts, but since home mortgages are considered consumer debts, most clients are subject to means testing. However, if the client has substantial IRS debts or substantial business-related debts, often the means test can be avoided. If someone "passes" the Means Test, they are eligible to file under chapter 7, and eliminate their unsecured debts. If they "fail", then they may only be eligible to file under chapter 13 with a required monthly payment, usually for five years.

A basic eligibility requirement for filing a case is the amount of debts carried by the client. For chapters 7 and 11, there are no limits. For chapter 13, the current limits are a maximum of \$383,175.00 for unsecured claims, and a maximum of \$1,149,525.00 for secured claims. These dollar amounts are periodically adjusted. If the client's debts exceed either limit, they are not eligible for chapter 13.

In addition to income considerations, there are other factors to consider in analyzing whether bankruptcy is an appropriate option, and if so, whether the case should be filed under chapter 7 or under chapter 13, and when it should be filed. A primary consideration is the equity in a client's assets. Particularly in a chapter 7, if the entire asset is not exempt from the claims of creditors, that asset can be forfeited. So, in any bankruptcy filing, there must be a review of what the client owns, and a determination of whether it can be protected. Chapter 7 is often called a liquidation bankruptcy for good reason. Through significant changes in the New York State exemption laws over the last several years (particularly for a home), most assets are protected in a typical case. By way of example, in Saratoga County, a person can exempt \$137,950.00 of equity in their home. If the home is jointly owned by a husband and wife, they can each claim the exemption, for a total of \$275,900.00. Note that

homestead exemptions vary amongst counties, and also note that there are choice of law provisions which can affect the exemptions, depending on where the client has resided for the past few years.

If a client has equity that would be lost in a chapter 7, the client could choose to file under chapter 13 to avoid liquidation. In such event, the amount to be paid back to the unsecured creditors may be directly related to the value of the equity. Alternatively, if the amount is low enough, the client can file under chapter 7 and then negotiate to pay the chapter 7 trustee the value of the equity.

Another factor to consider in whether to file bankruptcy is whether the client has made a fraudulent conveyance in the prior six years. A fraudulent conveyance is defined under New York State law, and at its core it is a transfer made for less than fair consideration at a time of insolvency. Such conveyances can be undone in bankruptcy, and the asset then liquidated to pay debts. If the conveyance was made to a former (rotten)boyfriend, the client may not care what happens. However, if they gave away their lake-front camp to their children, they certainly would care about losing it.

A similar issue arises when a client has repaid a loan to an "insider" within one year of filing bankruptcy. An insider includes family and business associates. Such payment can be forced to be paid into the bankruptcy estate to pay towards all creditors. A very unhappy day if your client just paid back his dear mother.

In addition to eliminating certain debts, a bankruptcy can have other beneficial results. A chapter 13 plan can restructure some debts, such as car loans and mobile home loans. Some income taxes can be discharged. Second mortgages can sometimes be eliminated in a chapter 13. Judgment liens can be removed in all chapters. Collection efforts can be stopped, including action by the IRS. Secured loans in default (typically mortgages and car loans) can be cured in a chapter 13 plan.

Bankruptcy is not always the best option to deal with debt issues, but often it is the most comprehensive option available to the client. A thorough review of the client's situation is required to determine the available options for the client's goals.

In future columns I intend to provide more specifics for some aspects of bankruptcy. If you have a particular issue in which you are interested, certainly let me know. Also, if you have a question regarding a debt issue faced by a client, feel free to ask me about it.

Debtors' Prison

I am often asked by clients, "Can I go to jail?" The reassuring answer is, "Absolutely not. There are no more debtor's prisons." But, for someone who is dishonest in their petition, jail is an option. In each issue I hope to present a teaching moment showing what not to do when seeking relief under the bankruptcy laws.

This issue's hapless debtor is Mr. Thompson.

Mr. Thompson went through a tortuous chapter 13 case in Illinois, but never quite finished the case. After the case was closed, it came to the attention of the authorities (the United States Attorney) that Mr. Thompson had failed to disclose \$28,129.55 that he received from a workers' compensation settlement. Non-disclosure is almost always a problem in bankruptcy, especially when the item omitted has substantial value. He has pled guilty to bankruptcy fraud, and is awaiting his sentence. He has no relief from his creditors, a felony conviction on his record, and the prospect of jail. A very bad day.