

**Training Manual for
Pro Bono Bankruptcy Training Program**

**MODULE 1 –
BANKRUPTCY OVERVIEW**

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MODULE 1 - BANKRUPTCY OVERVIEW

There are many factors a client will need to consider in deciding whether to file bankruptcy. The attorney's role is to help the client understand the factors that are relevant based on the client's specific financial situation. This will include reviewing with the client what may and may not be possible in the bankruptcy process. This Module assists attorneys in that process by providing information needed to effectively counsel consumer clients.

This Module provides an overview of bankruptcy law. It gives attorneys a general understanding of the legal issues that arise in a consumer bankruptcy case. After an overview of the sources of bankruptcy law and available chapters for bankruptcy protection, we explain the concept of the bankruptcy estate. This includes a discussion of exemptions, property that a debtor is permitted to remove from the bankruptcy estate and keep to assist with the fresh start. Next we explain the automatic stay in bankruptcy, which prohibits collection efforts against the debtor while the bankruptcy case is pending. We then explain the scope of the bankruptcy discharge and identify nondischargeable debts. In Sections 2 and 3, we provide an overview of chapter 7 and chapter 13 cases, respectively. Finally, in Section 4 we discuss important considerations in counseling a client who is considering filing bankruptcy.

1. KEY BANKRUPTCY CONCEPTS

Bankruptcy is a process under federal law designed to help individuals and businesses get protection from their creditors. In the short term, bankruptcy prevents continued efforts by creditors to collect debts. In the long term, bankruptcy can eliminate repayment obligations or provide for a restructuring of the debtor's obligations, thus enabling the debtor to obtain a fresh financial start. For creditors, bankruptcy offers the possibility of a fair and equitable distribution of the debtor's non-exempt assets. These two concepts, the fresh start and the fair and equitable distribution to creditors, are the common thread running through consumer bankruptcy law.

1.1 Sources of Bankruptcy Law

The Bankruptcy Code, title 11 of the United States Code, is the most important source of law in bankruptcy cases. The Code is broken down into chapters that, with the exception of chapter 12, are assigned only odd numbers. Chapters 1, 3, and 5 contain provisions that are generally applicable to all types of bankruptcies, such as chapter 1's definitions and rules of construction. The Code then has separate chapters creating the procedures and rights for different types of bankruptcy cases, including chapter 7 and chapter 13, which are most used in consumer cases. The jurisdictional provisions relevant to bankruptcy are found in title 28 of the United States Code.

Attorneys should also become familiar with the Federal Rules of Bankruptcy Procedure ("Bankruptcy Rules"), which are promulgated by the United States Supreme Court and amended from time to time. The Bankruptcy Rules not only detail various procedures to be used in bankruptcy cases, they also establish important deadlines. Attorneys should also determine whether there are supplemental local bankruptcy rules, general orders, or standing orders that

establish local procedural practices. These are typically published on the local bankruptcy court's website.

The Judicial Conference of the United States promulgates Official Forms that are required to be used in bankruptcy cases. The Advisory Committee on Bankruptcy Rules has completed work on a major revision of the Official Forms that are used for an individual debtor's bankruptcy filing. The first set of revised forms went into effect on December 1, 2013, and the remaining revised forms went into effect on December 1, 2015. Instruction on how to prepare these forms is covered in Module 3.

1.2 The Various Chapters

While there are six types of bankruptcy cases provided for under the Bankruptcy Code, the choice for most consumers will be between filing under chapter 7 or chapter 13. What is provided here is a short description of the various chapters that will assist the attorney in satisfying the certification in Part 7 of the bankruptcy petition (Official Form 101). In signing the petition, an attorney for an individual debtor who has primarily consumer debts certifies that the attorney has advised the debtor that he or she may proceed under chapter 7, 11, 12, or 13, and has explained the relief available under each chapter.

Chapter 7. A case filed under chapter 7 is often called a "liquidation." However this description is somewhat misleading because property is rarely liquidated in most consumer cases. In a chapter 7 case, the debtor's assets are examined by a court-appointed trustee to determine if anything is available to be sold or recovered for the benefit of creditors. Certain property cannot be liquidated by the trustee because it is "exempt." In most consumer bankruptcy cases virtually all of the debtor's assets are exempt and therefore may not be liquidated. At the conclusion of a chapter 7 case an eligible debtor will receive a "discharge" from his or her debts, except for certain debts that are not dischargeable, such as unpaid domestic support obligations.

Chapter 13. A case filed under chapter 13 is often called a "reorganization" because it provides for the "adjustment of debts." Chapter 13 cases work very differently than chapter 7 liquidations and provide the debtor with the opportunity to adjust his or her financial affairs without liquidating assets. In a chapter 13 case the debtor submits a plan to repay creditors all or part of the money owed them over a three to five year period, usually funded from the debtor's future income. If the plan meets the requirements set out in the Bankruptcy Code and is confirmed by the bankruptcy court, the debtor's payments under the plan are distributed to creditors by the chapter 13 trustee. Upon successful completion of the plan, the debtor receives a discharge similar to that received in chapter 7, though the chapter 13 discharge is somewhat broader by providing for discharge of some debts not discharged under chapter 7.

Chapter 11. Chapter 11 is designed for the reorganization of a business but is also available to individual consumer debtors. However, because its provisions are complicated and of questionable benefit for most low and moderate-income debtors,

and there are additional expenses, the filing of a chapter 11 petition by a consumer debtor is generally not advisable.

Chapter 12. Chapter 12 is designed to permit family farmers and fishermen to repay their debts over a period of time in a manner similar to chapter 13, usually from future earnings. Based on the eligibility requirements, use of chapter 12 is generally limited to those whose income comes primarily from a family-owned farm or commercial fishing operation.

Chapter 9. Chapter 9 provides for the reorganization of municipalities, much like a reorganization under chapter 11.

Chapter 15. Chapter 15 provides a mechanism for dealing with cross-border insolvency cases that involve debtors, assets, claimants, and other parties in interest located in more than one country.

1.3 Property of the Estate

The commencement of a bankruptcy case creates an “estate.” 11 U.S.C. § 541. Based on the broad definition of “property of the estate” found in section 541, virtually all assets and property interests of the debtor as of the time the case is filed come into the bankruptcy estate and are subject to being administered for the benefit of creditors if not exempt. Such property includes intangible, contingent, and future property interests, such as any interest a debtor has in a pending lawsuit or potential cause of action, or an anticipated tax refund.

Most property acquired by the debtor after commencement of a chapter 7 case does not come into the estate. There are exceptions, however, for certain types of property acquired within 180 days after filing, such as property acquired by bequest or inheritance, through a spousal property settlement or divorce decree, or as a life insurance beneficiary. 11 U.S.C. § 541(a)(5). In a chapter 13 case property of the estate also includes property and earnings acquired while the case is pending (which the debtor is permitted to possess and use), unless the case is converted to another chapter. 11 U.S.C. §§ 348(f) and 1306.

There are several Code provisions that make certain types of personal property no longer property of the estate based on specified triggering events. For example, if the debtor fails to timely redeem, surrender, reaffirm or take other action as indicated by the debtor on the Statement of Intention with respect to certain debts secured by personal property, the secured property is no longer property of the estate. 11 U.S.C. §§ 362(h) and 521(a)(6). The Statement of Intention is discussed in Modules 3 and 4. Pawned personal property is not or will no longer be property of the estate if the property is held by the lender (pawnshop) and the debtor or the trustee has not redeemed the property within the time period set under state law (or as extended under section 108(b) for an additional 60 days after the petition is filed). 11 U.S.C. § 541(b)(8).

1.4 Exemptions

In keeping with the “fresh start” purpose of bankruptcy relief, debtors are permitted to claim certain property as exempt in the bankruptcy process and are allowed to retain this property after bankruptcy free from creditors’ claims. 11 U.S.C. § 522(b), (c). Section 522(d) lists the exemptions available under the federal exemption scheme. In some states the debtor is given a choice between using either the state exemptions or the federal bankruptcy exemptions (in a joint case, both spouses must choose the same exemption scheme). Other states have “opted out” of the federal bankruptcy exemptions. In those states, the debtor is not given a choice and must claim exemptions under state law. However, even in “opt-out” states, the debtor may still use federal nonbankruptcy law exemptions, such as the exemption for Social Security benefits, 42 U.S.C. § 407. Also available in “opt-out” states is a special federal bankruptcy exemption that protects tax-exempt retirement funds in pension plans and individual retirement accounts (IRAs). 11 U.S.C. § 522(b)(3)(C).

Some “opt-out” states have enacted statutes that require the use of a special set of exemptions by its residents in federal bankruptcy cases. These exemptions are often somewhat different than the ordinary state exemptions applicable outside bankruptcy and, in some cases, are more generous to debtors in bankruptcy by using the same or very similar monetary amounts to those found in section 522(d).

1.4.1 Which Exemptions Apply?

The 2005 amendments to the Code changed the domiciliary provision that determines which exemption law applies in a bankruptcy case. 11 U.S.C. § 522(b)(3)(A). This issue generally arises only if the debtor has moved from one state to another within the two-year period prior to filing for bankruptcy.

The state exemption law that applies is determined by the state in which the debtor’s domicile has been located for the 730 days immediately preceding the petition filing date. If the debtor’s domicile has not been located in a single state for the entire 730-day period, then what controls is the state in which the debtor was domiciled for the most time during the 180-day period immediately preceding the 730-day period.

This calculation could render the debtor ineligible to claim any exemptions, for example if the applicable state exemption law requires that the debtor must reside within the state to claim exemption rights or if the law does not permit an exemption to be taken on property located outside the state. If the effect of section 522(b)(3)(A) is to render the debtor ineligible to claim any exemptions, the debtor may elect to exempt property under the federal exemptions in section 522(d), even if the state of the debtor’s domicile as determined by section 522(b)(3)(A) is an opt-out state. It may also be the case that the debtor is not subject to the opt-out provision of the applicable state because it applies only to residents or persons domiciled in the state, in which case the debtor could select the federal exemptions.

1.4.2 Dollar Amounts of Federal Bankruptcy Exemptions

In states that have not opted out of the federal bankruptcy exemptions, this partial list shows the dollar amounts of exemptions the debtor may claim under section 522(d):

Dollar Amounts of Federal Bankruptcy Exemptions	
Homestead - § 522(d)(1).....	\$27,900
Motor Vehicle - § 522(d)(2)	4,450
Household Goods - § 522(d)(3)	
Per Item Limit.....	700
Aggregate Limit.....	14,875
Jewelry - § 522(d)(4)	1,875
Wild Card - § 522(d)(5)	1,475
plus up to \$13,950 of unused homestead exemption	
Tools of the Trade - § 522(d)(6).....	2,800
Unmatured Life Insurance - § 522(d)(8)	14,875
Personal Injury Claims - § 522(d)(11)(D).....	27,900

These dollar amounts apply in cases filed on or after April 1, 2022, and they are adjusted every three years to account for inflation. 11 U.S.C. § 104(b). The exemption amounts are doubled when a married couple files together. 11 U.S.C. § 522(m).

1.4.3 Calculating Exemptions with Monetary Caps

In considering the value of property for exemption purposes, the question is not the property's original cost, but rather what the property could be sold for at the time the bankruptcy case is filed. It is often useful to imagine a hypothetical yard sale in estimating the value of personal property. Module 2 of these training materials discusses tools that may be helpful in valuing homes and cars. It is also important to understand how the concept of equity relates to exemption laws. If an exemption law provides that a debtor may exempt a car not to exceed \$3,000 in value, this exemption applies to \$3,000 of the debtor's equity in the car, not to the total value of the car. For example, if the debtor has a car worth \$8,000 with a \$6,000 car loan balance, the debtor has only \$2,000 in equity. The debtor can thus fully protect the \$8,000 car with the \$3,000 exemption.

1.4.4 Exempting Tax Refunds

Tax refunds, Child Tax Credits (CTC), and Earned Income Tax Credits (EITC) can be significant and needed assets for many lower-income debtors. To the extent that tax refunds and credits become property of the estate based on the timing of when the bankruptcy is filed, which is discussed in Module 2, the debtor will want to claim some or all of the tax refunds as exempt. In non-opt out states, this is typically done by claiming the wildcard exemption under section 522(d)(5), which can exempt up to \$15,425 in tax refunds depending upon how much of the unused homestead exemption is applied. In opt-out states, there may be a similar state wildcard exemption (though the dollar amounts are often less than the federal bankruptcy exemption), or there may be a specific state exemption for tax refunds. Attorneys should also review relevant case law as some courts have held that CTC and EITC payments can be exempted under state exemption laws that broadly cover the receipt of public assistance.

1.4.5 Protection of Exempt Property

A chapter 7 or chapter 13 bankruptcy may protect the debtor's exempt property from judgment creditors by removing certain liens. This power to "avoid" a lien that "impairs" the debtor's exemption is codified at 11 U.S.C. § 522(f). Debtors may avoid judgment liens on their home obtained by creditors before the bankruptcy was filed. This provision also permits the avoidance of certain nonpossessory, nonpurchase-money security interests in certain exempt personal property listed in § 522(f) (such as a nonpurchase-money security interest in household goods or furnishings). In addition, liens on personal property claimed as exempt may be eliminated in chapter 7 cases if the debtor "redeems" the property under 11 U.S.C. § 722 by paying the creditor an amount equal to the value of the collateral. These issues are discussed in Module 4 of these training materials.

Exempt property is not liable *during or after* a bankruptcy case for prepetition debts. 11 U.S.C. § 522(c). This generally applies even to nondischargeable debts, except for the following:

- Nondischargeable debts for taxes and domestic support obligations;
- Debts secured by liens not avoided during the bankruptcy;
- Certain nondischargeable debts owed to an insured depository bank; and
- Fraudulently obtained student loan or aid.

1.4.6 Homestead Exemption Limitations

Several provisions in section 522 prevent the debtor from taking full advantage of state homestead exemptions under certain circumstances. These limitations apply only when the debtor claims an exemption in homestead property under section 522(b)(3)(A) based on state or local law, and therefore may not be invoked to challenge a debtor's claim of exemption under section 522(d)(1) or under section 522(b)(3)(B) as property held as a tenant by the entirety to the extent the interest is exempt from process under nonbankruptcy law. The following are summaries of each homestead limitation (these issues come up very rarely):

- Section 522(o) provides that the bankruptcy court, upon an objection to the debtor’s claim of exemption by an interested party, may reduce the value of the debtor’s interest that may be exempted in homestead property to the extent that the interest is attributable to property that the debtor could not exempt, and that had been disposed of within 10 years before the filing of the petition with the intent to hinder, delay or defraud a creditor.
- Section 522(p)(1) provides that the debtor may not exempt interest in homestead property in excess of \$189,050 that was acquired by the debtor during the 1215-day period before the filing of the petition. The monetary cap does not apply to any interest transferred from a debtor’s previous principal residence to the debtor’s current principal residence, if the debtor’s previous residence was acquired before the 1215-day period and both the previous and current residences are located in the same state.
- Section 522(q) limits the debtor’s exempt homestead interest to \$189,050 if a party in interest asserting an objection to the debtor’s claim of exemption establishes that the debtor committed certain bad acts, such as being convicted of a felony which “under the circumstances, demonstrates that the filing of the case was an abuse of the provisions” of the Code. This exemption cap also may apply if the debtor owes a debt arising from violations of state or federal securities laws, any civil remedy under the Racketeer Influenced and Corrupt Organizations Act, or any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding five years.

1.5 Automatic Stay

The automatic stay is a fundamental cornerstone of the bankruptcy system. It is triggered instantly upon the filing of a bankruptcy petition. 11 U.S.C. § 362(a). With few exceptions, the automatic stay stops creditors from taking collection action, pursuing or continuing a court case against the debtor, or seizing any property of the debtor based on debts that arose before the bankruptcy petition was filed. The stay bars, for example, repossessions, attachments, foreclosures, property tax sales, and evictions. It stops actions taken to enforce a court judgment that may have been entered against the debtor before the bankruptcy case, such as a wage garnishment. Home foreclosures in states with a non-judicial procedure and self-help repossessions are stayed without the need for the debtor to seek an injunction or post a bond as is usually required in a state court action.

Utility shut-offs are also stayed, though service may be terminated later if a deposit or some other form of adequate assurance of future payment is not provided by the debtor during the first twenty days after the petition is filed. 11 U.S.C. § 366. The utility deposit requirements are covered in Module 2.

Section 362(b) creates a number of exceptions to the automatic stay. Many of these exceptions do not apply in consumer cases. Several of the exceptions that do occasionally apply to individual consumers relate to certain criminal cases and to proceedings concerning child support, visitation rights, domestic violence, and divorce. For example, the automatic stay does

not prevent the collection of a domestic support obligation from property that is not property of the estate.

Actions taken by a creditor in violation of the automatic stay generally are void. The debtor may be awarded actual damages and attorney fees as a remedy for willful violations of the stay. 11 U.S.C. § 362(k). Violations of the stay also may be punished by contempt.

1.5.1 Stay Limitations for Repeat Bankruptcy Filings

Section 362 was amended in 2005 to expand the circumstances under which the automatic stay does not go into effect or is terminated, mostly through amendments to section 362(b) and (c). Several changes were intended to respond to concerns about repeat bankruptcy filings, such as the following:

- If the debtor had a prior bankruptcy case that was dismissed within the previous year, the automatic stay expires after thirty days unless extended by the court. 11 U.S.C. § 362(c)(3).
- If the debtor has had two prior bankruptcy cases dismissed within the previous year, the automatic stay does not go into effect at all when the case is filed. 11 U.S.C. § 362(c)(4).

Even when these exceptions apply, however, some types of creditor actions may still be stayed. For example, some courts have held that the stay exception under section 362(c)(3) based on a prior dismissal within the year applies only to property of the debtor and not property of the bankruptcy estate such as the debtor's home and car. Also, the bankruptcy court can extend or impose the stay if a motion is filed and the court finds that the bankruptcy case has been filed in good faith. This is discussed in Module 4.

1.5.2 Stay Limitations Based on Court Order in Prior Case

The automatic stay does not prevent the enforcement of a security interest in real property if the debtor files a case during a period when the debtor is ineligible to be a debtor under section 109(g) or in violation of a prior court order prohibiting the debtor from being a debtor in another case. 11 U.S.C. § 362(b)(21). Ineligibility under section 109(g) is discussed in Section 2 below.

In addition, the automatic stay may not apply to specific real property for a period of two years after an *in rem* order has been entered in a prior case relating to the property and the order is recorded against the property in the local land records office. An *in rem* order may be granted if the secured creditor proves that the filing of the petition was part of a scheme to hinder, delay, or defraud creditors and the scheme involved either a (1) transfer of full or partial interests in the property without creditor or court approval, or (2) multiple bankruptcy filings involving the same property. The debtor may move in the subsequent case for relief from the *in rem* order based upon changed circumstances or for good cause shown. 11 U.S.C. § 362(b)(20), (d)(4).

1.5.3 Special Considerations in Eviction Cases

A special set of procedures applies to eviction cases. If an eviction case has been filed against the debtor, the automatic stay will prevent the landlord from proceeding with the eviction if the bankruptcy case is filed before the state court has entered a judgment for possession. If the bankruptcy case is filed after a judgment for possession has been entered, the full automatic stay will come into effect only for a period of thirty days, and then only if the debtor certifies, by checking the applicable boxes on Official Form 101A, that the debtor has:

- a right to cure the rent default under state law or applicable nonbankruptcy law (such as federal law dealing with public or subsidized housing), and
- deposited with the bankruptcy court the rent that will come due during the first thirty days of the bankruptcy case (usually one month's rent). 11 U.S.C. § 362(b)(22).

To obtain a stay for longer than this thirty-day period the debtor will need to pay the landlord all of the back rent owed, as stated in the judgment for possession, and file the certification on Official Form 101B. It is often difficult for debtors to satisfy these conditions. For this reason, if a default judgment for possession has been entered against the debtor, the best course of action may be to appeal or move to vacate the default judgment in state court before filing for bankruptcy, if there is any basis to do so, so that the stay restrictions of section 362(b)(22) do not apply.

Another exception to the automatic stay under section 362(a)(3) applies if the lessor files and serves on the debtor a certification under penalty of perjury that:

- an eviction action has been commenced based on endangerment of the property or illegal use of controlled substances on the property; or
- the debtor has within thirty days before the certification either endangered the property or illegally used or allowed to be used controlled substances at the property. 11 U.S.C. § 362(b)(23).

This stay exception goes into effect on the 15th day after the landlord files and serves the certification, unless the debtor files and serves on the lessor an objection to the truth or legal sufficiency of the lessor's certification. If the debtor files an objection, the stay exception does not go into effect, if at all, until after the court rules on it (a hearing is held within 10 days of the filing of the debtor's objection).

These stay exceptions permit only the continuation of proceedings stayed under section 362(a)(3), which means that the landlord is limited to taking actions to regain possession of the premises. The automatic stay still prevents the landlord from trying to collect any money judgment against the debtor personally for back rent or damages.

1.5.4 Duration of Automatic Stay

The automatic stay typically will remain in effect for the duration of the case, unless it is terminated by operation of the repeat filing provisions or by order of the court following the filing of a motion by a creditor or other party under section 362(d) (creditor motions for relief are discussed in Module 4). More specifically, sections 362(c)-(e) provide that the stay will terminate with respect to certain actions based on events such as the dismissal or closing of the case, or the entry of the discharge.

The stay against property of the estate continues until the earlier of:

- The date such property is no longer property of the estate (usually the date property is deemed abandoned at the close of the case under 11 U.S.C. § 554(c)); or
- The date on which an order of the court terminating the stay becomes effective.

The stay against any other act continues until the earliest of:

- The date the case is closed;
- The date the case is dismissed;
- The date a discharge is granted or denied; or
- The date on which an order of the court terminating the stay becomes effective.

The automatic stay with respect to a debt secured by personal property may also terminate if the debtor fails to timely redeem, surrender, reaffirm or take other action as indicated by the debtor on the Statement of Intention. 11 U.S.C. §§ 362(h) and 521(a)(6). The stay terminates at different time periods depending upon which of these provisions is applicable (either 30 days after the date first set for the meeting of creditors or 45 days after the conclusion of the meeting), unless the court orders otherwise. The Statement of Intention is discussed in Modules 3 and 4.

1.6 Discharge and Dischargeability

The primary goal of most consumer bankruptcies is the discharge of debts, thereby providing the debtor with relief from creditor collection actions and an opportunity for a fresh start. As discussed below, the discharge in a chapter 7 or chapter 13 case comes at the conclusion of the case, which may be approximately four months after filing in a chapter 7 case and generally three to five years after filing in a chapter 13 case. The discharge operates as an injunction, which prohibits creditors from taking or continuing any action to collect any discharged debt as a personal liability of the debtor. Violations of the discharge injunction may be punished by contempt.

1.6.1 Grounds for Denial of Discharge

In the vast majority of consumer cases, no proceeding is brought to challenge the debtor's right to a discharge and the debtor is granted a discharge. A party who objects to the debtor's discharge must file a complaint, no later than 60 days after the date first set for the meeting of creditors,

based on one or more of the grounds listed in section 727(a). That section provides that the court shall grant a discharge to an individual in a chapter 7 case (corporations and partnerships may not receive a chapter 7 discharge) unless the court finds that the debtor:

- Transferred or concealed property with intent to hinder, delay, or defraud a creditor or trustee;
- Destroyed or concealed financial records;
- Made a false oath or account, presented or used a false claim, given, offered, or received money, property, or advantage for acting or forbearing to act, or withheld books and records from the trustee;
- Failed to explain satisfactorily the loss or deficiency of assets;
- Refused to obey an order of the court or to testify after being granted immunity;
- Committed any of the above-listed acts within one year before the date of the filing of the petition or during the case, in connection with another case concerning an insider;
- Received a chapter 7 or chapter 11 discharge in a case commenced within the previous eight years;
- Received a chapter 12 or chapter 13 discharge in a case commenced within the past six years under certain circumstances;
- Executed a written waiver of discharge approved by the court;
- Failed to complete an approved financial education course after filing the petition;
or
- Claimed as exempt a homestead interest in excess of \$170,350 and the court finds that section 522(q) may be applicable.

1.6.2 Nondischargeable Debts

The discharge in chapter 7 covers all debts owed by the debtor except those that are specifically excluded under section 523(a). In chapter 13 cases, the exceptions to discharge are set out in section 1328(a). The exceptions to discharge of particular debts listed in these sections are narrowly drawn and construed by the courts.

Debts Excepted from Discharge by Operation of Law. Some debts are nondischargeable simply based on the fact that they are of the type specified in sections 523(a) and 1328(a). If the creditor contends that the debt is covered by one of these exceptions to discharge, the creditor is not required to bring an action in the bankruptcy court to have the debt declared nondischargeable and may take action against the debtor once the automatic stay is lifted or the bankruptcy case is closed. The debtor retains the right after bankruptcy to defend a state collection action by asserting that the debt has been discharged because it is not the type specified in section 523(a) or 1328(a), or the debtor may move to reopen the bankruptcy case and assert that the creditor has violated the discharge injunction issued under section 524(a). However it is often advisable for the debtor to have the bankruptcy court decide the dischargeability issue while the bankruptcy case is pending.

The following is a partial list of debts that are excepted from discharge by operation of law:

- Money owed for child support or alimony (referred to as a “domestic support obligation”);
- Most fines and penalties owed to government agencies;
- Most taxes and debts incurred to pay nondischargeable taxes (a more detailed discussion of income tax dischargeability is provided in Module 2);
- Student loans, except if the debtor can prove to the court that repaying them will cause an “undue hardship;”
- Debts not listed in the debtor’s bankruptcy schedules;
- Debts incurred by driving while intoxicated;
- Debts the debtor has formally agreed to repay by entering into a reaffirmation agreement.

For a debt that is not listed on the debtor’s bankruptcy schedules, some courts have held that the debt may still be discharged if the creditor received actual notice of the bankruptcy in a timely manner. And, in a chapter 7 case where there are no assets to be distributed to creditors, courts have held that a debt that is otherwise dischargeable may be discharged even if the creditor was not listed. However, other courts find that the exception to discharge for unlisted debts is applicable in all situations. Advocates should become aware of any controlling local precedent on this issue, and if needed, should attempt to amend the debtor’s schedules to add any previously omitted debts.

Debts Excepted from Discharge Only if Timely Action Brought. Another group of debts may be nondischargeable, but only if the particular creditor seeks a determination from the bankruptcy court by filing an adversary complaint within a strict time limit (sixty days after the first date set for the meeting of creditors) and proves that the debt should not be discharged. 11 U.S.C. § 523(c); Bankruptcy Rule 4007(c). The types of debts in this category are:

- Debts obtained by a false representation or fraud, or a false financial statement, that was reasonably relied upon by the creditor;
- Debts for fraud or defalcation while acting in a fiduciary capacity;
- Debts for willful and malicious injury by the debtor to another or property of another (applicable only in a chapter 7 case).

A few creditors will threaten to bring nondischargeability proceedings based on fraud even when debtors have done nothing wrong. Their goal is often to pressure debtors into agreeing to reaffirm a portion of the debt, knowing that the litigation costs for the debtor may exceed the settlement offer. Most experienced debtor attorneys will advise their clients not to reaffirm a debt in this situation and that such creditors almost always do not file a nondischargeability complaint. Moreover, if the creditor loses a nondischargeability action alleging that a debt was obtained by fraud and the court finds that the creditor’s position was not substantially justified, the court shall grant the debtor an award of reasonable attorney fees and costs. 11 U.S.C. § 523(d).

1.6.3 Presumption of Fraud

In a dischargeability action brought by a creditor, the following debts are presumed to be nondischargeable:

- a consumer debt for luxury goods or services of more than \$800 to a single creditor incurred by the debtor within ninety days before filing for bankruptcy, or
- a cash advance of over \$1,100 on an open-end credit account obtained by a debtor within seventy days before filing. 11 U.S.C. § 523(a)(2)(C).

To rebut the presumption the debtor will need to show that there was no intent to obtain the debt by fraud, such as by establishing that there was good reason to incur the debt and that the debtor did not intend to file bankruptcy when it was incurred. To avoid this issue it is generally best to advise debtors during the initial interview that they should discontinue any further use of credit cards if they intend to file bankruptcy. The presumption also can be avoided by delaying the filing of the bankruptcy case.

1.7 Automatic Stay, Exemptions and Discharge in Practice

The following examples help to illustrate how the automatic stay and discharge operate in a consumer bankruptcy case. The examples involve debts owing on payday loans and government benefit overpayments.

1.7.1 Payday Loans

A payday loan is a short-term loan in which the consumer borrows a small amount of money at a high interest rate, often at an annual percentage rate (APR) between 250% and 400%. The consumer writes a check to the lender for the amount borrowed, plus a fee that is either a percentage or a flat dollar amount, or signs an agreement to debit his or her bank account automatically. The check (or debit agreement) is then held until the consumer's next payday or receipt of a government check. The consumer can redeem the check by paying the face amount, allow the check to be cashed or the account debited, or pay another fee to extend the loan. Often the "roll-over" of these loans through repeated extensions puts low-income consumers in an endless cycle of debt.

Automatic Stay and Exemption. If the debtor files for bankruptcy while a payday loan is outstanding, some payday lenders have taken advantage of an exception to the automatic stay by cashing the debtor's check after the bankruptcy is filed. This exception in section 362(b)(11) provides that the stay does not prevent the "presentment of a negotiable instrument." Although some courts have held that the exception applies and that the payday lender is not liable for damages under section 362(k) for violation of the stay, all courts seem to agree that the cashing of the check is an unauthorized postpetition transfer of estate property that is avoidable under section 549(a). If the trustee does not attempt to recover the funds, and the debtor claims the funds as exempt, the debtor may avoid the transfer under section 522(h)(1) and (2). In fact, a payday lender's refusal to turn over the check proceeds once notice of the

stay has been given may be deemed a violation of the stay that would give rise to damages under section 362(k).

Dischargeability. Payday loans are dischargeable just like other unsecured debts (payday lenders have not been successful in arguing that the loans are secured debts). Payday lenders occasionally claim that fraud is involved if the debtor gets a payday loan shortly before filing for bankruptcy, and that the debt is therefore nondischargeable under section 523(a)(2). However, as discussed above, this exception to dischargeability requires that the lender bring a proceeding within a strict time deadline (sixty days after the date first set for the meeting of creditors) and prove that the debt was obtained by fraud. Often the lender is unable to prove all of the required elements of a fraud claim. Also, a payday loan that at first appears to be a recent advance may actually be a “roll-over” of a loan taken long before the bankruptcy case was filed.

1.7.2 Government Benefit Overpayments

Some debtors may seek bankruptcy relief because the limited income they receive from a government benefit program is being reduced to recover an overpayment of benefits. The question of how such overpayments are treated in bankruptcy often turns on the type of benefit program involved and the distinction between setoff and recoupment. Both setoff and recoupment involve situations in which the debtor and creditor are obligated to each other. The creditor’s withholding of a payment due the debtor is recoupment if the mutual obligations arise out of the same transaction or contract. If the mutual obligations arise out of different transactions or contracts, the creditor’s action is a setoff.

Automatic Stay. The automatic stay prohibits the **setoff** of any debt owing to the debtor that arose before the bankruptcy against any claim against the debtor. 11 U.S.C. § 362(a)(7). By contrast, a postpetition **recoupment** does not violate the automatic stay. For Social Security and public assistance benefits, including Supplemental Security Income (SSI) and Temporary Assistance for Needy Families (TANF), courts have routinely held that the program’s recovery of a prepetition overpayment from the debtor’s right to receive postpetition benefits is a setoff (*i.e.*, arises from a different transaction because of ongoing postpetition eligibility requirements) that violates the automatic stay. *See Lee v. Schweiker*, 739 F.2d 870 (3d Cir. 1984). For other programs, such as unemployment compensation and Veterans Administration benefits, it is not so clear. Courts are divided on whether recovery of overpayments under these programs involves recoupments that would not be stayed.

Dischargeability. There is no special exception to discharge for benefit overpayments solely because the debt is owed to the government. Additionally, the withholding of benefits after bankruptcy is not a setoff permitted under section 553 because that provision applies only when the mutual debts both arise prepetition (the debtor’s right to future benefits arises postpetition). If the government agency takes the position that the overpayment is a debt incurred by fraud, it must, like any other creditor, initiate a proceeding within sixty days after the date first set for the meeting of creditors to have the debt declared nondischargeable under section 523(a)(2). Agencies will of course have a difficult time proving fraud when the overpayment was caused by their own administrative error. Even if the debtor might be at

fault, the debtor may not have engaged in an intentional misrepresentation or omission that would amount to actual fraud.

2. OVERVIEW OF CHAPTER 7

Chapter 7 bankruptcy cases are usually straightforward. Occasionally complications arise, but most chapter 7 cases proceed without any contested hearings or appearances before the bankruptcy judge. A timeline of the major events and deadlines in a chapter 7 case is provided as an attachment to this Module.

2.1 Eligibility to File

Any individual who lives in the United States or has property or a business in the United States can file a chapter 7 bankruptcy. There are few preconditions to a bankruptcy filing, although a judge can dismiss a chapter 7 case if the filing is an abuse of the bankruptcy system. Such dismissals are rare but may occur if the debtor is using bankruptcy for an improper purpose (such as to harass creditors) or if the debtor has substantial income available to pay debts. The debtor must also obtain a briefing from an approved credit counseling agency within 180 days before filing the petition, as discussed in Module 2.

An individual is not eligible to file a bankruptcy petition if, within the 180-day period before filing the petition:

- she was the debtor in a bankruptcy case that was dismissed for willful failure to abide by orders of the court or for failure to properly prosecute the case; or
- she obtained a voluntary dismissal of the bankruptcy case following the filing of a request for relief from the automatic stay. 11 U.S.C. § 109(g).

The circumstances surrounding a prior dismissal should be explored fully with a potential client before filing a petition within the 180-day period. The docket in the prior case also should be reviewed for entry of a dismissal order that might contain a section 109(g) refiling bar. Failing to pay filing fees or to appear at the meeting of creditors in a prior case, or failing to make plan payments in a prior chapter 13 case, without some additional aggravating factors, generally will not be considered a willful violation of a court order for purposes of section 109(g).

2.2 Repeat Bankruptcy Filings

A debtor who received a chapter 7 bankruptcy discharge is disqualified from receiving a discharge in another chapter 7 case for a period of **eight years**. The time is measured from the filing date of the petition in the earlier case. This disqualification from receiving a chapter 7 discharge also applies if the debtor was granted a discharge in a chapter 13 case filed within **six years** before filing the chapter 7 case, unless unsecured creditors with allowed claims were paid in full, or payments made under the chapter 13 plan in the earlier case totaled at least seventy percent of the allowed unsecured claims and the court finds that this result was the debtor's best effort and that the chapter 13 plan was proposed in good faith. 11 U.S.C. § 727.

2.3 “Means Test”

As part of the 2005 Code amendments, Congress created a “means test” in 11 U.S.C. § 707(b) intended to make it more difficult for wealthy consumers to file a chapter 7 bankruptcy. This section applies only to a chapter 7 debtor whose debts are primarily consumer debts. If the debtor’s “current monthly income” is above the median family income for the debtor’s state of residence, the debtor must fill out the “means test” forms (Official Forms 122A-1, 122A-1 Supp, and 122A-2) requiring detailed information about income and expenses. If the form shows, based on standards set out in section 707(b), that the debtor has a certain amount of income left over that could be paid to unsecured creditors, a presumption arises that the filing is an abuse. If the debtor cannot rebut the presumption or show that there are special circumstances, the bankruptcy court may decide that the debtor cannot file a chapter 7 case. In that case the debtor can either convert the case to chapter 13 or the chapter 7 case will be dismissed.

Most consumers who file bankruptcy, especially those served by pro bono programs, are not affected by the means test because of its safe harbor provisions. In particular, section 707(b)(7) provides that if the debtor’s “current monthly income” (defined as the debtor’s average monthly income over the six months prior to the month the case is filed) is below the median family income for a household of this size in the debtor’s state of residence, the bankruptcy judge, United States trustee (or bankruptcy administrator), trustee, and other parties in interest are prohibited from filing a motion seeking to apply the means test. Essentially, any debtor below the median income may file under chapter 7 without any presumption of abuse.

The calculation of current monthly income and application of the safe harbor and means test are discussed in Module 2.

2.4 First Steps

The first step in a chapter 7 case is the completion of the bankruptcy forms and other required documents. Initially these include a “petition,” a statement of compliance with the credit counseling requirement, and a mailing list including all of the debtor’s creditors. A number of other forms must also be filed either at the same time as the petition or shortly afterwards (generally fourteen days after filing the petition). These include a statement of financial affairs, a statement of intentions with respect to certain secured debts, a set of schedules listing all of the debtor’s debts, property, income and expenses, a statement of current monthly income and means test calculations, copies of pay stubs (referred to as “payment advices”) received by the debtor from an employer during the sixty days before the petition date, and the certificate from an approved agency verifying completion of the credit counseling requirement. All of these forms must meet certain specifications required by the Bankruptcy Rules and many of the forms used are Official Forms issued by the Judicial Conference of the United States. 11 U.S.C. § 521; Bankruptcy Rules 1007, 4002. Most courts require that these forms be filed electronically. Module 3 discusses how to prepare the bankruptcy forms.

Within a few weeks after the bankruptcy filing the bankruptcy court will send a notice of the automatic stay and of the date and place scheduled for a “meeting of creditors.” This notice will

be sent to all creditors, the trustee, and the debtor (and the debtor's attorney). It also informs parties in interest as to whether the presumption of abuse arises under section 707(b), and lists important deadlines in the case, such as the deadline for interested parties to file a complaint objecting to discharge or to determine the dischargeability of a particular debt. If the debtor has checked the box on the petition indicating that there is not likely to be a distribution of funds in the case the notice will also inform creditors that they should not file a proof of claim unless they receive a subsequent notice advising them to do so.

2.5 Chapter 7 Trustee

After the debtor files a bankruptcy case, a trustee is appointed as the representative of the debtor's bankruptcy estate, which generally includes all property interests of the debtor on the date of filing. The trustee is selected from a "panel" of private trustees established by the Executive Office of the United States Trustee. 11 U.S.C. § 707(a)(1). The panel trustee's name and address is listed on the notice of the meeting of creditors. In a chapter 7 bankruptcy, in addition to conducting the meeting of creditors, the trustee will collect any nonexempt property that can be sold, handle any sale, distribute the property to creditors with valid claims, and make a final accounting to the court.

2.6 United States Trustees

The United States Trustee Program is a component of the United States Department of Justice under the direction of the Attorney General. The program covers all states except Alabama and North Carolina (where bankruptcy administrators serve a similar function). There is one United States Trustee for each of nineteen regions, and each trustee is appointed by the Attorney General. 28 U.S.C. § 581. The United States trustee may appear and be heard on any issue in any bankruptcy case or proceeding. 11 U.S.C. § 307. In addition, the duties of the United States trustees and the United States Trustee Program, as set forth in 28 U.S.C. § 586 and various provisions of the Bankruptcy Code, include:

- Establishing and supervising a panel of private trustees to administer chapter 7 cases;
- Supervising the administration of cases and trustees in chapter 7, 11, 12, 13, and 15 cases;
- Monitoring plans in chapter 11, 12, and 13 cases;
- Approving and supervising credit counseling agencies for the bankruptcy briefing and the financial education course;
- Reviewing means test forms and asserting claims of abuse under section 707(b);
- Reviewing and objecting to professional fees when appropriate;
- Reviewing disclosure statements and applications for the retention of professionals;
- Referring matters to the United States attorney for investigation and criminal prosecution when appropriate.

2.7 Meeting of Creditors

The meeting of creditors, also sometimes referred to as the section 341 meeting, is conducted by the chapter 7 trustee. It gives the trustee and others a chance to examine the debtor under oath

and ask questions about the debtor's financial affairs, to ensure that the debtor's bankruptcy schedules are correct and complete. Despite the name, few creditors appear at the meeting of creditors in a consumer bankruptcy. However the debtor (or both debtors in a joint case) must attend. Preparation for the meeting of creditors is discussed in Module 4.

At least seven days before the section 341 meeting the debtor must provide to the trustee a copy of his or her federal income tax return (or tax transcript thereof) for the most recent tax year ending immediately before the commencement of the case, if a federal income tax return was filed. The debtor will be required to bring certain documents to the meeting, unless otherwise provided under local rules, such as a copy of the debtor's most recent bank statement, a picture form of identification, proof of current income such as the debtor's most recent pay stub, and some proof of the debtor's Social Security number (or a written statement that the debtor does not have a Social Security number or that no proof is available). 11 U.S.C. § 521; Bankruptcy Rule 4002. These requirements are discussed in more detail in Module 4.

2.8 Retention of Exempt Property

In the initial bankruptcy schedules, the debtor must list and estimate the value of the debtor's real and personal property, and can select which property to claim as exempt. Unless there is a timely objection to the debtor's claim of exemptions, the debtor is permitted to keep the property listed as exempt in the schedules. A party in interest who wishes to file an objection to the debtor's exemptions (for example, to argue that the asset is worth more than the debtor says, and cannot be fully exempted) must do so within thirty days after the conclusion of the meeting of creditors. Bankruptcy Rule 4003(b). If the trustee or parties in interest do not file a timely objection to an exemption, it is deemed allowed. *See Taylor v. Freeland & Krantz*, 503 U.S. 638 (1992). However, if the exemption claimed by the debtor is capped at a specific dollar amount and the debtor claims a certain dollar amount as exempt, but the value of the asset later turns out to exceed this amount (this happens most commonly with legal claims still being litigated), the trustee or parties in interest may file an objection to the claim of exemption even after the thirty-day deadline set by Bankruptcy Rule 4003(b) has passed. *See Schwab v. Reilly*, 130 S. Ct. 2652 (2010). This outcome often can be avoided by careful preparation of the debtor's schedules, for example by claiming the debtor's entire interest in the asset as exempt (even if the value of the asset is unknown) rather than a fixed dollar amount.

Nonexempt assets must be turned over to the trustee, who will sell them and distribute the proceeds among the creditors. Property that is mostly, but not totally, exempt is usually abandoned by the trustee, which means that the property will not be liquidated. In the typical consumer chapter 7 bankruptcy, in which the trustee determines that the case is a "no-asset" case, the trustee files a Report of No Distribution within sixty days after the meeting of creditors. 11 U.S.C. § 704(a)(9).

2.9 Secured Creditors Stay Secured

The general rule applicable to both chapter 7 and 13 is that secured creditors remain secured. Unless the court orders otherwise, the creditor's lien will pass through the bankruptcy unaffected. This means that if the debtor is in default on a secured debt, the creditor can still foreclose or seize

the collateral (although it will have to wait until the automatic stay is lifted in order to do so), even though the debtor's personal liability is wiped out with the discharge. A debtor may file a motion to avoid, or remove, a judgment lien that impairs her exemptions (as discussed in section 1.4.5 and explained in detail in Module 4). Another exception uniquely available in chapter 7 is redemption of personal property under 11 U.S.C. § 722. The debtor may file a motion to redeem the collateral securing a claim, pay the creditor an amount equal to the value of the collateral, and retain the property free and clear of the lien. Modification of certain liens and payment of secured claims (including curing defaults) is also possible in chapter 13 cases.

2.10 Reaffirmation Agreements

A reaffirmation is an agreement entered into during bankruptcy by the debtor with a particular creditor in which the debtor agrees to remain legally obligated on some or all of a debt that would otherwise be discharged. Such agreements must meet specific requirements provided in section 524 to be enforceable. These requirements and potential alternatives to reaffirmation with respect to secured debt are discussed in more detail in Module 4.

2.11 Granting of Discharge

The debtor is granted a discharge approximately sixty days after the meeting of creditors unless:

- A complaint objecting to the debtor's discharge based on the grounds listed in section 727(a), or a motion to extend the time to file such a complaint, is pending;
- The debtor has not timely filed a certification with the court evidencing completion of an educational course on personal finances;
- The debtor has not paid the filing fee in full (if not waived);
- A motion to dismiss under section 707 is pending;
- Court review of a filed reaffirmation agreement is pending due to a presumption of undue hardship under section 524(m);
- A motion is pending to delay the granting of the discharge in case in which the debtor has claimed as exempt a homestead interest in excess of \$170,350 and section 522(q) may be applicable (until the events that could trigger a potential exemption objection under section 522(q) are determined).

A few other procedural events that would prevent or delay the granting of the discharge are listed in Bankruptcy Rule 4004(c), but these generally do not arise in consumer cases. Once granted, the court sends a copy of the discharge order to the debtor, to the debtor's attorney, and to all creditors. Shortly thereafter the court will close the case.

3. OVERVIEW OF CHAPTER 13

Most of the initial steps in a chapter 13 case are quite similar to those in chapter 7. The major difference is that in chapter 13 a reorganization plan is filed. Debtors must also begin making payments under that plan within thirty days after filing. The following overview points out some of the other significant differences in procedure in chapter 13 cases.

3.1 Eligibility to File

Chapter 13 is available to “individuals with regular income” who live in the United States or have a place of business or property in the United States. A debtor with “regular income” includes not only wage earners but also recipients of government benefits, alimony or support payments, or any other regular type of income. As under chapter 7, the debtor must obtain a briefing from an approved credit counseling agency within 180 days before filing the petition.

Unlike chapter 7, there are limits to the amount of debt that a debtor may have as a chapter 13 filer. A temporary amendment to section 109(e), effective on June 21, 2022 and expiring on June 21, 2024, eliminated the distinction between secured and unsecured debt and increased the debt ceiling so that chapter 13 is not available to debtors (or debtor couples) with over \$2,750,000 in liquidated, noncontingent debts. If this amendment is not extended or made permanent before it expires in two years, the debt limits will revert to the former amounts, making chapter 13 not available to debtors (or debtor couples) with over \$465,275 of non-contingent, liquidated, unsecured debts or over \$1,395,875 of non-contingent, liquidated, secured debts (these amounts are adjusted for inflation every three years). 11 U.S.C. § 109. Also, the debtor may be ineligible to file a chapter 13 case if the 180-day refiling bar under section 109(g) applies based on a prior bankruptcy dismissal, as discussed in section 2.1 above.

3.2 Repeat Bankruptcy Filings

The debtor may file a chapter 13 case even though he or she has received a chapter 7 discharge within the past eight years. However, section 1328(f)(1) provides that a discharge cannot be entered in a chapter 13 case if the debtor received a discharge in a prior chapter 7, 11, or 12 case that was filed within **four years** before the date of the chapter 13 petition in the later case; nor can a discharge be entered in a chapter 13 case if the debtor received a discharge in a prior chapter 13 case that was filed within **two years** before the date of the chapter 13 petition in the later case. The section 1328(f) bar to discharge is calculated from the filing date in the first case (the date the order of relief was entered upon filing of the petition) to the filing date in the second. Unlike chapter 7, there may be reasons to file a chapter 13 case even if the debtor cannot obtain a discharge. For example, the debtor may be able to save a home from foreclosure by curing a mortgage default in the chapter 13 plan.

3.3 First Steps

As in chapter 7, a chapter 13 bankruptcy case begins with the filing of a petition. The additional schedules, statement of financial affairs, and other documents must be filed either with the petition or shortly thereafter (generally fourteen days after the petition date). Rather than Official Forms 122A-1 and 122A-2, the chapter 13 debtor files a statement of current monthly income and calculation of commitment period (Official Form 122C-1) and calculation of commitment of disposable income (Official Form 122C-2). A chapter 13 plan must also be filed with the schedules. This plan is the debtor’s proposal detailing when and how much creditors will be paid.

Unlike in chapter 7, the debtor in a chapter 13 case is required to file by the day before the first scheduled section 341 meeting, with both state and federal taxing authorities, all tax returns that the debtor was required to file for the tax periods ending in the four years before the petition was filed. 11 U.S.C. § 1308(a). This provision does not require that the returns be filed with the bankruptcy court but rather that the tax returns be filed with the appropriate taxing authorities. If the debtor was not required to file a return for a particular tax period (because the debtor's income for the year was below a certain level), no return need be filed. If returns are not filed by the deadline the trustee may hold the section 341 meeting open for a period of up to 120 days or, for a return that was not past due on the petition date, until the last automatic extension date. The debtor may also move for an extension of time to file returns beyond the time established by the trustee, but not more than thirty days after the trustee's deadline or, for a return that was not past due on the petition date, beyond the last automatic extension date. The debtor must demonstrate that the failure to file the returns is for reasons beyond the debtor's control.

As in chapter 7, the petition sets the bankruptcy process in motion. The filing immediately establishes the automatic stay. Within a few weeks after the filing, the bankruptcy court will send a notice of the stay and of the date and place scheduled for the meeting of creditors to all creditors, to the trustee, and to the debtor.

3.4 Codebtor Stay

Unlike chapter 7, the automatic stay in a chapter 13 case also puts into effect a stay that prevents creditors from taking any action against codebtors (cosigners) who have not filed for bankruptcy, if the debt is being paid under the debtor's chapter 13 plan. 11 U.S.C. § 1301. This stay prevents, for example, a creditor from pursuing collection against a friend or family member who may have cosigned a loan with the debtor. It applies only to a "consumer debt," as defined in 11 U.S.C. § 101(8). The codebtor stay remains in effect until the chapter 13 case is closed, dismissed, or converted to another chapter, or until it is lifted by the court upon a creditor's request. To obtain stay relief, the creditor must show that the cosigner rather than the debtor received the consideration for the debt, that the debtor's plan does not provide for the debt, or that the creditor's interest will be irreparably harmed if the stay is not lifted.

3.5 Chapter 13 Trustee

The chapter 13 trustee has more to do than the chapter 7 trustee. In addition to the duties of a chapter 7 trustee, the chapter 13 trustee must review the debtor's plan to ensure that it complies with the law and object to confirmation if it does not. If the plan is confirmed, the chapter 13 trustee collects the debtor's payments and distributes that money to creditors who have filed a proof of claim. Any creditor who wishes to get paid from the estate must file a proof of claim using Official Form 410 in accordance with Bankruptcy Rules 3001, 3002, and 3002.1. Both the debtor and the trustee can file an objection to a creditor's proof of claim if the debtor has defenses to owing the money. Bankruptcy Rule 3007. The bankruptcy judge will then hold a hearing on the objection and decide how much the creditor should be paid.

In some judicial districts there may be only one “standing” trustee who is appointed for all chapter 13 cases, unlike chapter 7 cases in which the “panel” trustee is selected from a list of trustees. The chapter 13 trustee is usually entitled to a commission of up to ten percent of the payments made through the plan.

3.6 Meeting of Creditors

The meeting of creditors is conducted by the chapter 13 trustee. The meeting of creditors gives the trustee and others a chance to examine the debtor and ask questions about the debtor’s financial affairs and the feasibility of the debtor’s plan. As in chapter 7 cases, few creditors appear at the meeting of creditors. The same document production requirements that apply in chapter 7 cases, which are discussed above and in more detail in Module 4, also apply in chapter 13 cases. 11 U.S.C. § 521; Bankruptcy Rule 4002.

3.7 The Debtor’s Chapter 13 Plan

The debtor’s chapter 13 plan payments are based on the debts to be paid under the plan, the requirements of chapter 13, and the debtor’s ability to pay based on disposable income. Unsecured creditors may receive a share of the payments made under the plan. Depending upon the amount of the debtor’s nonexempt property and income left over after paying necessary living expenses (or upon a fixed formula for above-median income debtors), the plan may pay unsecured creditors at less than one-hundred percent of what they are owed, in some cases as low as zero to ten percent. In most cases consumers are not required to pay unsecured creditors for any interest, late fees, and other penalty charges incurred once the chapter 13 case is filed. In most districts local rules require the use of a model plan or may set certain requirements for the form of the plan.

3.8 Length of Plan

A chapter 13 plan normally provides for monthly payments to the chapter 13 trustee over a period of three years. However plans can last up to five years if the court, for cause, approves a longer period. 11 U.S.C. § 1322(d). Consumers with incomes above the state’s applicable median family income may be required to either remain in chapter 13 for a five-year period or make payments that equal the amount paid in a five-year plan, in what is referred to as the “applicable commitment period.” 11 U.S.C. § 1325(b).

3.9 Plan Confirmation

The court will evaluate the debtor’s plan at a “confirmation hearing.” This generally occurs between twenty and forty-five days after the meeting of creditors, though this time period is extended in some districts based on local practice. The court will determine at the hearing whether the requirements of chapter 13 have been met and will hear any objections to approval of the plan raised by creditors or the trustee. In many courts a formal confirmation hearing will be held only if an objection to confirmation is filed.

For various reasons the debtor may want to modify his or her original plan after it is filed. A plan can be modified before confirmation so long as the modified plan meets the chapter 13 requirements. 11 U.S.C. § 1323. Plans can still be modified after confirmation at the request of the debtor, the trustee, or an unsecured creditor, subject to court approval. 11 U.S.C. § 1329.

3.10 Plan Confirmation Tests

The following matters must be considered by the debtor in developing the plan and by the court in deciding whether to confirm the plan:

Best Interest of Creditors Test. The plan must provide that unsecured creditors will be paid at least as much as they would receive if the debtor's estate were liquidated under chapter 7. 11 U.S.C. § 1325(a)(4). In situations in which the debtor has equity in his or her home or other property in excess of any allowed exemptions, the plan may need to provide for a larger distribution to unsecured creditors and, in some cases, unsecured claims may need to be paid at one-hundred percent of the allowed amount plus interest.

Good Faith Test. Another requirement is that the plan must be proposed in "good faith and not by any means forbidden by law." 11 U.S.C. § 1325(a)(3). While plans providing zero percent or very small dividends to unsecured creditors are not *per se* proposed in bad faith, such plans may receive close scrutiny, even in the absence of any formal objection. However, the debtor's payment ability and the amount to be paid to unsecured creditors are generally considered under the ability to pay test discussed below. The 2005 amendments also added a plan confirmation standard based on whether the bankruptcy petition was filed in good faith. 11 U.S.C. § 1325(a)(7). The test of good faith is often highly fact-specific.

Ability to Pay Test. The debtor must commit all of the debtor's disposable income to the plan for the three or five years the plan will be in effect. 11 U.S.C. § 1325(b). "Disposable income" is defined, at least for a below-median income debtor, as current monthly income (other than child support payments, foster care payments, or disability payments for a dependent child) less amounts reasonably necessary for the maintenance or support of the debtor or dependents of the debtor, or for a domestic support obligation that becomes due after the petition date. For above-median income debtors, section 1325(b)(3) provides that reasonably necessary expenses are to be calculated using the means test formula in section 707(b)(2)(A) and (B) in order to determine payments to unsecured creditors. It considers the actual amounts the debtor spends for some expenses but uses fixed amounts based on IRS collection guidelines for other expenses. When a low or no dividend plan is proposed and an objection is filed, the court will carefully review the debtor's schedules, particularly the income and expense amounts listed on Schedules I and J (Official Forms 106I and 106J), or Official Form 122C-2 for an above-median income debtor, to determine whether additional payments could be made to unsecured creditors.

Feasibility. The debtor must be able to make the proposed plan payments. 11 U.S.C. § 1325(a)(6). The court will consider whether the income and expenses disclosed by the debtor in Schedules I and J, as well as the debtor's payment record up to the time of confirmation, support the debtor's ability to make the plan payments.

3.11 Right to Cure Defaults

One of the most significant advantages of chapter 13 is the right to cure defaults on loans, even when this right does not exist outside of bankruptcy. For claims based on long-term loans that the debtor may not be able to pay within the three to five years of a chapter 13 plan, such as a home mortgage, section 1322(b)(5) permits the debtor to cure a default on such loans within a reasonable time by making payments on the arrears and the ongoing postpetition payments during the course of the plan. Section 1322(b)(3) can also be used to cure defaults on short-term loans. Payment of interest on arrearage claims paid through the plan may be required only if this is provided for in the underlying contract and is permissible under applicable nonbankruptcy law. 11 U.S.C. § 1322(e).

3.12 Treatment of Secured Claims

Section 1325(a) provides that the court shall approve a plan if certain standards are met. One of these standards applies to secured claims. 11 U.S.C. § 1325(a)(5). It states that as to each allowed secured claim provided for by the plan one of the following conditions must be met:

- *For collateral the debtor does not wish to keep*, the plan may provide for surrender of the collateral in satisfaction of the creditor's allowed secured claim;
- *For collateral the debtor wishes to keep*, the plan may be confirmed if the secured creditor accepts the plan; or
- *For collateral the debtor wishes to keep*, the plan may be confirmed if the plan provides that the secured creditor retains its lien and the present value of the payments to be made under the plan on the claim will not be less than the allowed amount of the claim.

To satisfy the present value requirement, interest generally must be paid on an allowed secured claim, but this interest may be different than the contract rate. 11 U.S.C. § 1325(a)(5)(B). The Supreme Court in *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), held that the proper formula to be used in calculating the interest required is to use the prime rate of interest as the starting point, and then adjust it by a factor for risk. The prime rate of interest may be found on the Federal Reserve Board website at: <http://www.federalreserve.gov/releases/h15/current/>.

3.13 Modification of Secured Claims

Section 1322(b)(2) provides that the debtor's plan may modify the rights of holders of secured claims. Several notable exceptions discussed below apply to claims secured only by a security

interest in real property that is the debtor's principal residence and to motor vehicles recently purchased before filing bankruptcy.

3.13.1 Bifurcation

In determining the allowed amount of a secured claim, section 506(a) provides that the claim is secured only to the extent of the value of the collateral, and that any amount of the claim in excess of the value of the collateral will be treated as an unsecured claim. This bifurcation or "stripdown" of the creditor's claim means that the unsecured portion of the claim will be paid with other unsecured claims, based on the plan's treatment of unsecured claims, often providing payment of less than one-hundred percent. In addition to claim bifurcation, section 1322(b)(2) permits the plan to modify the rights of holders of secured claims, such as by extending the payment term or adjusting the installment payment amount under the underlying contract.

3.13.2 Stripdown Limitations

There are several limitations on the debtor's ability to bifurcate and modify secured claims in chapter 13 cases. Although section 1322(b)(2) generally authorizes the modification of allowed secured claims by a chapter 13 plan, an exception preventing modification is provided for those claims secured only by a security interest in real property that is the debtor's principal residence. *See Nobleman v. American Savings Bank*, 508 U.S. 324 (1993). However, most courts have held that *Nobleman* does not apply when (1) a junior mortgage is totally undersecured because senior liens equal or exceed the value of the property (referred to as "stripoff"), or (2) when the mortgage is not secured only by the debtor's home but also by other valuable collateral, such as rental units the debtor does not occupy in a multifamily dwelling (referred to as "stripdown"). In addition, section 1322(c)(2) provides that short-term, balloon payment or other mortgages having a final payment that comes due during the life of a chapter 13 plan may be modified.

3.13.3 The "Hanging Paragraph"

Another major limitation on claim bifurcation applies to a purchase money security interest for a debt incurred within 910 days preceding the filing of the petition, if the collateral for the debt consists of a motor vehicle that was acquired for the personal use of the debtor. A similar limitation applies to a purchase money security interest for a debt incurred within one year preceding the filing of the petition, if the collateral consists of any other "thing of value." For claims based on these security interests, as set forth in language added in 2005 at the end of section 1325(a) which was not given a section designation (and therefore referred to as the "hanging paragraph"), the provisions of section 506(a) permitting claim bifurcation may not be applicable. However, the "hanging paragraph" does not prevent other modifications of these claims by a chapter 13 plan, such as extension of the loan payment schedule or paying less than the contract rate for interest based on section 1325(a)(5)(b).

3.14 Plan Payments

The debtor must begin making plan payments to the trustee within thirty days after filing the petition, unless the court orders otherwise. 11 U.S.C. § 1326(a). In most jurisdictions bankruptcy courts routinely approve requests to have the monthly payments to the trustee paid automatically by wage deduction. Depending upon the terms of the debtor's proposed plan, or if required by the court, the debtor may need to begin making adequate protection payments directly to some secured creditors within thirty days after filing the petition. 11 U.S.C. § 1325(a)(5)(B)(iii). The payments made to the chapter 13 trustee are held and not paid out to creditors until the chapter 13 plan is confirmed by the court, although adequate protection payments (if made through the trustee) may be disbursed to certain secured creditors prior to confirmation. If the court does not confirm the plan, the payments are returned to the debtor after deduction of administrative costs.

3.15 Granting of Discharge

The final step in a successfully completed chapter 13 case is the discharge. As in chapter 7, the debtor must complete an educational course on personal finances before the discharge will be granted. A certification that the debtor has taken the course must be filed before the last chapter 13 payment required under the plan is made. Bankruptcy Rule 1007(c). Other certifications related to the payment of domestic support obligations and the claiming of certain homestead exemptions, as discussed in Module 4, may need to be filed by the debtor. Following the submission of a final report by the chapter 13 trustee showing that the debtor has completed the chapter 13 plan, the court will grant the debtor a discharge. The chapter 13 discharge can be enforced in the same way as the chapter 7 discharge, through contempt proceedings. If a creditor has willfully misapplied payments received under a chapter 13 plan and this has resulted in material injury to the debtor, an action may be brought for violation of sections 524(i) and 524(a)(2).

Some debtors are unable to complete their chapter 13 plans, usually because of loss of income. When this occurs four options are normally available, each having somewhat different consequences:

- **Modification.** It is possible to modify a plan to address new problems, but creditors have a right to object to the modification and, if they do so, the court will decide whether to allow the modification. 11 U.S.C. § 1329.
- **Hardship Discharge.** The debtor may file a motion to obtain a hardship discharge if the debtor's problems are caused by circumstances for which the debtor "should not justly be held accountable," and only if modification of the chapter 13 plan is not practical and the payments made to unsecured creditors are not less than they would have received if the case was originally brought under chapter 7. 11 U.S.C. § 1328(b).
- **Conversion.** The debtor has the right to convert a chapter 13 case to a chapter 7 case. 11 U.S.C. § 1307(a). After the conversion any nonexempt property is liquidated as

would normally be true in a chapter 7 case, and the debtor will receive a chapter 7 discharge.

- **Dismissal.** Occasionally, dismissal is preferable to any of the other options. The debtor has the right to dismiss a chapter 13 case unless the case was previously converted from a chapter 7 or chapter 11 case. 11 U.S.C. § 1307(b).

3.16 Nondischargeable Debts

Before the 2005 amendments, the discharge received in a chapter 13 case was broader than its counterpart in chapter 7, and was often referred to as the “superdischarge.” Now most of the debts that are nondischargeable in chapter 7 are treated in the same manner in chapter 13. Although more limited, section 1328(a)(2) continues to permit the discharge in chapter 13 cases of some debts that are nondischargeable in chapter 7. The following is a partial list of such debts that remain dischargeable in chapter 13 cases:

- Debts for willful and malicious injury to property (and in some cases to individuals if section 1328(a)(4) does not apply);
- Certain civil fines and penalties, including some tax penalties;
- Certain debts for which discharge was denied or waived in a previous bankruptcy case;
- Debts incurred to pay nondischargeable tax obligations;
- Non-support debts arising from property settlements in divorce or separation proceedings, as provided under section 523(a)(15); and
- Homeowner association (HOA) debts incurred postpetition if the debtor has vacated the property.

There is also a provision in chapter 13 that excepts from discharge long-term debts with final payments due after the completion of the plan, such as home mortgages. This applies if the long-term debt is provided for in the debtor’s plan under section 1322(b)(5) through the curing of a default and maintenance of ongoing payments. 11 U.S.C. § 1328(a)(1). That is to say, although the chapter 13 plan allows the debtor to cure the arrearage on this kind of long-term debt, it is not included in the chapter 13 discharge.

With respect to debts incurred by fraud, Bankruptcy Rule 4007(c) provides that the same time limits that are applicable to other chapters are applicable in chapter 13 cases. Thus a complaint objecting to dischargeability based on fraud (under section 523(a)(2) and (a)(4)) in a chapter 13 case must be filed no later than sixty days after the first date set for the section 341 meeting.

4. COUNSELING THE CONSUMER BANKRUPTCY CLIENT

One of the first steps in advising a client about whether to file bankruptcy is to review what is and is not possible in bankruptcy. Very often a decision not to file will be made quickly once the client becomes aware that certain perceived benefits cannot be achieved by filing

bankruptcy. On the other hand, a debtor struggling with a wage garnishment may have little hesitation about filing after being informed that bankruptcy will stop the garnishment.

4.1 What Bankruptcy Can Do

Bankruptcy may make it possible for the debtor to:

- Eliminate the legal obligation to pay most or all debts. This is done by the granting of a “discharge” at the close of a successful bankruptcy case.
- Stop foreclosure on a home and allow the debtor an opportunity to cure a default.
- Prevent repossession of an automobile or other personal property, or force the creditor to return property even after it has been repossessed.
- Stop garnishment of wages or a bank account (and get back money taken in the 90 days before filing), debt collection harassment, and other similar collection activities.
- Prevent termination of utility service or restore service if it has already been terminated.
- Prevent government agencies from recovering public assistance or Social Security overpayments, unless the overpayment was obtained by fraud.
- Lower the monthly payments on some debts, including some secured debts such as car loans.
- Allow the debtor to get back his or her driver’s license if it was lost due to inability to pay a judgment related to a car accident (so long as the debt was not incurred through drunk driving).
- Provide an opportunity to challenge the claims of certain creditors who have violated federal or state consumer protection law, or who have engaged in fraudulent or other unlawful conduct.

4.2 What Bankruptcy Cannot Do

Bankruptcy, however, cannot cure every financial problem, nor is it an appropriate step for every individual. In bankruptcy it is usually not possible to:

- Modify rights of certain secured creditors. Although the debtor can force secured creditors to take payments over time in the bankruptcy process to cure a default, some secured creditors are afforded protection from other modifications of the loan terms.
- Discharge certain types of debts singled out by the Bankruptcy Code for special treatment, such as child support, alimony, most student loans, court restitution orders, criminal fines, and most taxes.
- Protect all cosigners on their debts. When a relative or friend has cosigned a loan and the debtor discharges the loan in bankruptcy, the cosigner may still have an obligation to repay all or part of the loan. However there are certain protections for cosigners if the debtor files a chapter 13 bankruptcy.
- Discharge debts that are incurred after bankruptcy has been filed.

4.3 Advantages of Bankruptcy

There are many other factors the debtor will need to consider in deciding whether bankruptcy is the right choice. The debtor will need to weigh the advantages and disadvantages of filing. The following are some of the key reasons why consumers decide to file bankruptcy:

- ✓ **Discharge of Most Debts.** The primary goal of most consumer bankruptcies is to provide the debtor with relief from creditor collection actions and an opportunity for a fresh start. This goal is accomplished through a discharge of most, if not all, of the debtor's debts. The discharge entered in a bankruptcy case under section 524 serves as an injunction barring collection of all discharged debts.
- ✓ **Automatic Stay.** Section 362 provides that most creditor actions (including repossessions, garnishments, foreclosures, utility shut-offs, and evictions) against the debtor and property of the debtor must stop immediately upon the filing of the bankruptcy petition. The protection of this automatic stay generally extends for the entire period the bankruptcy case is pending. The automatic stay is replaced by the discharge injunction as to dischargeable debts when the case is closed, providing permanent protection to the debtor.
- ✓ **Right to Cure Defaults.** A chapter 13 debtor is given the opportunity to cure prepetition defaults on secured and unsecured debts under section 1322(b)(5), even if such a right does not exist under state law. A default may be cured even if the creditor has given notice of acceleration and initiated the foreclosure process before the chapter 13 case is filed, as long as the chapter 13 case is filed before the foreclosure sale. 11 U.S.C. § 1322(c).
- ✓ **Modification of Certain Secured Debts.** Secured claims may be modified in a chapter 13 case under sections 1322 and 1325. The modification may permit the debtor to pay less than the full amount claimed to be owed on the claim (based on the value of the collateral), and to modify the contract interest rate and timing of payments. However, there are limitations on this right to modify for certain home mortgage loans and loans for recently purchased vehicles.
- ✓ **Protection of Exempt Property from Judgment Creditors.** Debtors are permitted to claim certain property as exempt in the bankruptcy process and to retain this property after bankruptcy free from creditors' claims. In addition, a chapter 7 or chapter 13 bankruptcy may protect the debtor's exempt property from collection actions of a judgment creditor by providing for the avoidance of judgment liens (and certain nonpossessory, nonpurchase-money security interests) under section 522(f), to the extent such liens impair the debtor's exemptions. In addition, liens on personal property claimed as exempt may be eliminated in chapter 7 cases through redemption under section 722. Redemption requires the debtor to pay the amount of the allowed

secured claim as determined by section 506(a).

- ✓ **Litigation in Bankruptcy Court.** Bankruptcy court may be an appropriate forum for a debtor to assert consumer defenses and claims as part of the claims allowance process, most often in chapter 13 cases. Such claims and defenses may be brought in the form of an “adversary proceeding” in response to a creditor’s proof of claim, and may be based on federal consumer protection statutes or state lending laws. Proceedings of this kind normally fall within the bankruptcy court’s jurisdiction under 28 U.S.C. § 1334(b), and may be treated as a “core proceeding” under 28 U.S.C. § 157(b).

4.4 Disadvantages of Bankruptcy

The following are some of the reasons why some consumers may chose not to file bankruptcy:

- ✗ **Nondischargeability of Some Debts.** While the general discharge provides a valuable benefit for most consumers, there are certain debts that may not be discharged in a bankruptcy case, such as most student loans, alimony and child support, debts obtained by fraud (if the fraud is proven), restitution obligations and criminal fines, and debts incurred after the bankruptcy case is filed. Exceptions to the general discharge are provided in sections 523(a) and 1328(a).
- ✗ **Possible Loss of Property.** The debtor may have equity in certain property beyond the allowed exemption amount and therefore filing a chapter 7 case would result in liquidation of the property. A chapter 13 case may not be feasible for a debtor in this situation because unsecured creditors generally may not be treated worse in chapter 13 than in chapter 7 and, therefore, the debtor may be compelled to make plan payments which are simply unaffordable. 11 U.S.C. § 1325(a)(4). Even in this situation a debtor may elect to file bankruptcy so as to gain the protection of the court while attempting to sell property. The debtor may be able to partially exempt and recover any potential equity resulting from a voluntary sale during the bankruptcy, which probably would have been lost at a foreclosure sale or other forced sale outside of bankruptcy.
- ✗ **Secured Creditors Retain Liens and the Right to Take Collateral if in Default.** A bankruptcy case may not assist a debtor in retaining property that serves as security for certain debts, such as home mortgages or car loans. Even though the debtor’s underlying personal obligation on the secured debt will be discharged, security interests on property generally pass through a bankruptcy unaffected if not avoided, modified, or satisfied during the bankruptcy. If the debtor’s personal obligation on a secured debt is discharged, a secured creditor has no right to seek a deficiency judgment or to collect money from the debtor, but may pursue its rights under state law solely to enforce the lien. So while the debtor will gain the protection of the automatic stay while the case is pending and ultimately will gain the discharge of personal liability on the secured debt, bankruptcy may not enable the debtor to save the house or the car, unless the debtor can afford to file under chapter 13. Options for retaining collateral in bankruptcy cases are discussed in Module 4.

- ✘ **Impact on Credit Rating.** Under the Fair Credit Reporting Act, information about a bankruptcy filing can be reported on a consumer’s credit report for a period of ten years after the case is filed, rather than the normal seven years allowed for other credit information. 15 U.S.C. § 1681c(a)(1). Still, many consumers are able to obtain credit after filing bankruptcy, though it may pose a problem in getting approved for a conventional home mortgage. Most mortgage lenders will not hold the bankruptcy against the debtor if the debtor has reestablished a good credit reputation for a period of two to four years after the discharge. In appropriate cases consumers concerned about their credit rating may wish to participate in a reputable credit counseling program as an alternative to bankruptcy (and all individual debtors are required under section 109(h) to obtain a credit counseling briefing before filing bankruptcy).
- ✘ **Moral Obligations.** Most people want to pay their debts and make every effort to do so if payment is possible. Some debtors also have a strong feeling of moral obligation to pay their bills or may be concerned about the stigma associated with bankruptcy. These debtors may be opposed to any suggestion that they should file bankruptcy. Debtors may have been advised by a credit counselor or collection agent that bankruptcy should be avoided at all costs. By consulting with an attorney, debtors can at least obtain objective information about their legal rights. Ultimately debtors must decide whether the potential hardships on themselves and their families in not filing outweigh their moral concerns. It may be helpful to inform clients that the United States Constitution includes a provision for bankruptcy (Article 1, Section 8), and that many big corporations (Kmart, American Airlines, Chrysler, Johns Manville, and Macy’s) and famous people (Toni Braxton, Kim Basinger, Tammy Wynette, Larry King, Mickey Rooney, Henry Ford, and Milton Hershey--the chocolate bar king) have chosen to file bankruptcy. In addition, the *Bible* mentions the need for debt forgiveness and a process similar to bankruptcy (*Deuteronomy 15:1-2*).
- ✘ **Possible Discrimination.** Debtors may also be concerned that they may be discriminated against for having filed bankruptcy. However, in most cases, section 525(a) provides that “governmental units” are not permitted to discriminate on this basis. In addition private employers may not terminate employment, or discriminate with respect to employment (though this may not apply to hiring decisions), based upon a bankruptcy filing or discharged debts. 11 U.S.C. § 525(b). Finally, discrimination with respect to student loans or grants based upon the discharge of a prior student loan is also prohibited. 11 U.S.C. § 525(c).
- ✘ **Concern About Future Debt.** For certain debtors it may be advisable to wait before filing bankruptcy. If the debtor is currently “judgment-proof,” there may be little advantage to filing at a time when creditor action will not result in the loss of the debtor’s property or income. Moreover, if the problems causing the debtor’s financial situation have not been resolved, or if a bankruptcy is filed at a time when the debtor does not have adequate automobile or health insurance, the debtor may be worse off if substantial obligations are incurred after filing. This is because a debtor may not obtain another chapter 7 discharge for a period of eight years after the filing of a chapter 7 case in which a discharge was received (though the filing of a chapter 13 case may be

possible). 11 U.S.C. § 727(a)(8). Although it may seem counterintuitive, often the best time for a debtor to file is when his or her financial situation has improved slightly, and there is a threat of immediate creditor action.

4.5 Advising the Judgment-Proof Debtor

Special care should be taken in advising low-income debtors that are judgment-proof. A person is judgment-proof (or more accurately “collection-proof”) if his or her income and property are exempt from collection under state or federal law. For example, if a debtor’s only income is Social Security benefits, these benefits are legally protected from garnishment. Even if the creditor gets a judgment against such a debtor, legally, the creditor cannot touch the debtor’s Social Security benefits. (The creditor may be able to take a judgment lien on the debtor’s house, but is unlikely to foreclose that lien if there is a mortgage in first position.) However, being judgment-proof does not protect the debtor from the creditors’ efforts to collect the debt. Judgment-proof debtors may still be sued in court and may receive harassing telephone calls and letters from creditors. Additionally, judgment-proof status is not a permanent condition. Execution on later-acquired, non-exempt assets or non-exempt income can come years down the road.

In the short term, bankruptcy may provide the judgment proof debtor with peace of mind, but it will not significantly change the debtor’s financial position. In some cases a simple “stop contact” or “cease communication” letter from the client to the debt collector may provide the same relief from upsetting and harassing debt collection efforts. The federal Fair Debt Collection Practices Act (FDCPA) requires collection agencies and attorneys to stop dunning consumers after receiving a written request asking the collector to cease collection contacts or stating that the debt is not owed. 15 U.S.C. § 1692c(c). Creditors collecting their own debts are not covered by the FDCPA, but they often comply with such requests. Both creditors and debt collectors may also be subject to state debt collection laws.

Judgment-proof clients should be advised that filing a bankruptcy case now may impair the right to file another case in the years ahead. The same bankruptcy relief will almost always be available later. Unless a judgment-proof debtor expects to soon acquire non-exempt property, waiting may be the better course. However even those clients who are not in danger of sustaining a tangible loss may value the elimination of debt burdens that flows from bankruptcy. Ultimately, the client must make the choice.

4.6 Alternatives to Bankruptcy

Most consumers file bankruptcy only as a last resort after carefully considering alternatives to bankruptcy. Still, it is advisable for the attorney to review possible alternatives with the debtor as well as to review the consequences of not filing bankruptcy. Debtors struggling to keep up with unmanageable debt will need to weigh alternatives such as those described below against the hardships that may be avoided by obtaining bankruptcy relief. In some cases these alternatives are not practical and bankruptcy simply may be the best or only realistic choice.

4.6.1 Credit Counseling

Bankruptcy law requires that, before filing bankruptcy, a consumer must first meet with an approved credit counseling agency. This requirement is discussed in Module 2. Because most consumers who are considering bankruptcy are already too deep in financial trouble, the approved bankruptcy counselors are often unable to recommend any viable options in credit counseling. Nevertheless, the pre-filing counseling does provide an opportunity for debtors to review their income, expenses, and other budget considerations and perhaps identify the causes of their financial problems. In many cases the process simply confirms for the debtor the need to proceed with bankruptcy.

Some credit counselors, including some of the approved bankruptcy counseling agencies, may offer debt management plans (also called DMPs) as a way of avoiding bankruptcy--whether it makes sense or not. A DMP is a plan for a consumer to repay debts by sending a monthly payment to the counseling agency that is then distributed to creditors. The plan may involve some concessions on the part of the creditor, but usually only the waiver of some late fees and other charges, and possibly a slight reduction in interest rate. Although DMPs share some similarities with chapter 13 bankruptcy plans, DMPs generally do not provide for reduction in the amount of principal the debtor owes and do not deal with secured debt. In addition, the required payment on the DMP may not be affordable, and if the debtor does not complete the DMP, the debts will revert to their original terms.

4.6.2 Debt Settlement

Unlike credit counseling agencies, most debt settlement and debt negotiation agencies are for-profit businesses. Negotiation and settlement services are different from debt management services mainly because the debt settlement agencies do not send regular monthly payments to creditors. Instead, these agencies generally maintain the debtor's funds in separate accounts, holding the money until the agency believes it can settle debts for less than the full amount owed.

Consumers should be wary of debt settlement companies because they often make false or unrealistic claims about their ability to settle debts for less than the amount owed. Another problem with debt settlements is that the consumers targeted by debt settlement companies are generally the least likely to benefit, so that very few consumers ever complete a debt settlement program. Unlike bankruptcy and its automatic stay, consumers in debt settlement programs continue to face collection efforts and their debts continue to grow as creditors add on fees and interest continues to accrue. In some cases the debt settlement fees are so high that consumers do not end up saving much in the "reserve accounts" used to settle debts. Finally, there are potential tax consequences for the consumer if debts are written off. Debts discharged in bankruptcy, on the other hand, are generally not treated as income to the debtor for tax purposes. 26 U.S.C. § 108(a)(1)(A).

4.6.3 Housing Counseling

Clients often have multiple debt problems and multiple objectives. For these clients, bankruptcy may be the first choice because of the centralized forum it creates to resolve all of the debtor's financial problems and because of the benefits of the discharge. However some clients may have a problem with only one debt, often a home mortgage, which they have fallen behind on because of a temporary loss of income. In that situation the most effective way to resolve the problem and avoid foreclosure may be for the client to enter into a workout agreement or loan modification with the mortgage lender or servicer. The Department of Housing and Urban Development (HUD) maintains a database of HUD-approved counseling agencies. A list of those agencies may be obtained by calling HUD at (800) 569-4287 or visiting the HUD website at www.hud.gov or <http://www.consumerfinance.gov/find-a-housing-counselor/>.

A housing counselor may be able to assist with a workout option that enables the homeowner to address either a temporary financial hardship or a long-term or permanent reduction in income. While there are a variety of workout options, three common examples are a repayment plan, a forbearance plan, and loan modification.

- ✓ **Repayment Plan.** A repayment plan (also known as a reinstatement agreement or deferral agreement) involves curing a default by making the regular monthly mortgage payments as they are due, together with partial monthly payments on the arrears (including fees and costs). For example, a typical agreement might call for making one-and-a-quarter monthly payments until the default is resolved. This type of agreement is similar to a cure of arrears that is possible in a chapter 13 bankruptcy, although over a shorter time period—usually no more than 6 or 12 months. The lender or servicer may require that the agreement be in writing if the homeowner is more than three months in arrears.
- ✓ **Forbearance Plan.** A forbearance plan allows homeowners who are unable to pay the mortgage due to a serious event (unemployment, illness, divorce, and so forth) to make a reduced payment or no payment for a period of time. The lender agrees that during this time of reduced or suspended payment, it will “forbear” from foreclosing. However, at the end of the forbearance plan, typically the total arrearage is due and payable. Thus, a forbearance gives the homeowner time to recover from the event that caused the financial hardship or to obtain stable income, but when the forbearance concludes, the homeowner will need to catch up the arrearage, possibly by qualifying for a loan modification or filing a chapter 13. A written agreement is usually required.
- ✓ **Loan Modification.** In some cases mortgage holders will agree to permanent changes in loan terms, such as a permanent interest rate reduction, an extension of the loan's payment period, reamortization, cancellation or forbearance of principal, or some combination of these changes. An agreement of this type occurs most frequently when the borrower can no longer afford the original loan terms due to a change in circumstances or financial hardship, and it is not in the mortgage holder's financial interest to foreclose. The debtor may be eligible for assistance under certain loss

mitigation programs, such as those intended to help debtors who face hardships caused by natural disasters and the COVID-19 pandemic. These programs have specific eligibility requirements and may require the borrower to participate in a trial plan for several months before conversion to a permanent loan modification occurs. More information about these programs is available in chapter 12 of NCLC's Mortgage Servicing and Loan Modifications, updated at www.nclc.org/library.

- ✓ **Mortgage Workout Compared to Chapter 13 Bankruptcy.** A chapter 13 bankruptcy can often be structured to give the homeowner a plan similar to a mortgage workout. But there are differences. Unlike a workout involving a loan modification, a chapter 13 bankruptcy plan will generally not change the interest rate or loan term for the mortgage as a whole, and will not involve forgiveness of delinquent amounts. There are also expenses to file a bankruptcy case and a portion of the payments paid under the plan (up to ten percent) will be retained by the bankruptcy trustee as a commission. On the other hand, a chapter 13 plan may provide more time to catch up on the arrears than a repayment plan. While these agreements rarely extend longer than twelve months, a chapter 13 plan may allow a mortgage arrearage to be paid over several years-- as long as three to five years. The bankruptcy filing will also stay most adverse actions against the homeowner, including foreclosure, giving the homeowner ample time to develop and carry out the repayment plan. The bankruptcy proceeding may also provide a forum for the debtor to resolve a prepetition dispute with the lender or servicer regarding the correct amount of the arrearage, and to address debt problems with other lienholders on the property and other creditors.

4.6.4 Consolidation Loans and Reverse Mortgages

It is usually not a good idea for a debtor to mortgage a home to pay off credit card and other unsecured debt. By trading in credit card debt for a mortgage loan, the debtor risks the loss of the home if financial problems persist. Refinancing an existing mortgage may make sense, but usually only if the debtor is having difficulty paying the current mortgage payment and the new mortgage will provide a lower payment and better terms. Also, if the mortgage contains abusive terms or involves unlawful practices by the lender or servicer, potential consumer protection violations should be explored, possibly through a referral to an attorney who specializes in such cases, before refinancing is considered.

A reverse mortgage allows older homeowners to borrow on the equity in their homes, but operates differently than a traditional mortgage. Unlike a traditional home equity loan, repayment is not required until the borrower sells the home, moves out permanently, or dies. The amount of money the borrower owes increases over time because no payments are made. The lender pays the loan proceeds to the borrower either in a lump sum, in monthly installments, or as a line of credit. Reverse mortgage options may be confusing, and there are many things to consider before deciding whether a reverse mortgage can help. Before applying for a reverse mortgage a borrower should get counseling from an impartial housing counselor. More information about reverse mortgages and the approved housing counselors is available from the Department of Housing and Urban Development (HUD) at www.hud.gov.

CHAPTER 7 BANKRUPTCY TIMELINE ("ROUTINE" CONSUMER CASE)

DATE	ACTION
Within 180 days before petition filing date	Debtor receives credit counseling briefing from approved agency—§ 109(h)
Petition filing date	Case initiated by filing petition, mailing matrix; Filing fee paid or waiver/installment application filed; Order for relief entered; Panel trustee appointed; Section 341 meeting date set
14 days after petition filed	Balance of schedules, counseling certificate, current monthly income and means test statement, payment advices (received within 60 days prepetition) due if not filed with petition—Rule 1007(c)
At least 7 days before first date set for § 341 meeting	Tax return or transcript to be provided to trustee for most recent tax year ending immediately before petition date for which a return was filed— Rule 4002(b) <i>Note:</i> copy of return or transcript also to be provided to creditor if request made at least 14 days before first date set for § 341 meeting
30 days (approximately) after petition date	Section 341 meeting held; Debtor to bring recent bank statement, picture ID, proof of current income, and proof of Social Security number—Rule 4002(b)
45 days after petition date	Deadline for filing all documents required by § 521(a)(1), or motion for extension of time (up to 45 days), to avoid automatic case dismissal
Within 30 days after first date set for § 341 meeting (45 days if purchase money security interest on personal property involved)	Debtor must perform intention as provided on Statement of Intention—§ 521(a)(2), (6)
30 days after conclusion of § 341 meeting	Deadline for objections to claim of exemptions— Rule 4003(b)
60 days after first date set for § 341 meeting	Deadline for filing certification of financial education course completion—Rule 1007(c); Deadline for objection to debtor's discharge—Rule 4004(a); Deadline for objections to dischargeability of a particular debt—Rule 4007(c); Deadline for filing reaffirmation agreement and cover sheet (Official Form 427)—Rule 4008(a)
3–4 months (approximately) after petition filed	Report of no distribution filed by trustee; Discharge entered; Case closed