

Individual Counseling on Debt and Chapter 7 Bankruptcy

Overview

- Introduction to Chapter 7 and 13
- Identifying debtor personalities
- Pre-filing counseling
 - Alternatives to managing debt
 - Obtaining information to determine if bankruptcy is appropriate
- Reaffirmation
- The Discharge

Common Consumer Bankruptcy Chapters

- Chapter 7
 - Liquidation
 - If no significant assets and no red flags, personal liability on debt will be discharged and no property will actually be taken
 - Involuntary liens may be removed by motion (i.e. judgment liens)
 - Voluntary liens cannot be removed (i.e. mortgage, HOA lien, attorney fees lien by contract)
- Chapter 13
 - Repayment
 - Three to five year repayment plan
 - Need income
 - Must maintain debt payments moving forward and plan payments
 - i.e. payment on mortgage arrears and current monthly mortgage payments; payment on HOA arrears and current monthly HOA assessments
 - Voluntary liens might be crammed down by motion if they impact equity

Chapter 7 Bankruptcy

- Debtors who are low-income may not actually need a bankruptcy
- If they do, or insist on filing, a Chapter 7 is usually best
- Before advising to file, you should be aware of what a bankruptcy cannot do
- A bankruptcy cannot
 - Create income
 - Help a debtor keep a car or home if they cannot afford to pay
 - Stop an eviction, foreclosure, storage unit sale, or repossession for more than a few weeks

Chapter 7 Bankruptcy

- Debtors may not be aware of how invasive the bankruptcy process is
- The bankruptcy trustee and court have a right to obtain and review:
 - Tax returns
 - Bank statements
 - Property transfers
 - Property value
 - Reasons for certain payments or debts
- Creditors, especially ex-spouses, ex-friends, and ex-partners can question debtors about debts and property

Debtor Personalities and Bankruptcy

- Different Debtor Personalities
 - I have no idea what to do
 - I'm someone who always pays my bills so even though I don't have any money I'd like to consolidate my debts and pay because I'm a good person
 - What's bankruptcy?
 - I really don't want to file but I feel like I have no choice and I'm ashamed and I never meant to not be able to pay and I'm someone who always pays my bills so I'm sorry
 - My mother's sister's cousin's friend's mechanic told me I should file
 - I want to repair my credit
 - I WILL file and you can't say anything to stop me

Pre-filing Counseling

- Despite the different personalities, the pre-filing counseling is the same. Determine:
 - Information about what got the debtor here
 - If there are any other options aside from bankruptcy
 - What the debtor's goal(s) are
 - Whether bankruptcy can accomplish those goals
 - Whether bankruptcy will have unintended consequences
 - If bankruptcy appears to be appropriate, gather documents

Pre-filing Counseling

- Information about what got the debtor here (emotionally, physically, and situationally)
 - Generally overwhelmed by debt but no lawsuit?
 - Denial of credit/rental application?
 - Lawsuit?
 - Garnishment or levy?
 - Referred by friend/family/agency

Pre-filing Counseling

- Are there any other options aside from bankruptcy
 - Discuss consequences and process itself to discourage filing
 - No-contact letters/collection-proof discussion
 - Dispute credit/rental denial or obtain copy of report used to deny credit/rental
 - Respond to lawsuit
 - If debtor is not collection-proof, assist with claim of exemption
- Many people are pushed into debt settlement or negotiating a lump sum
 - This is often not necessary and can often result in further debt, including tax consequences

Pre-filing Counseling

- What are the debtor's goal(s) and can bankruptcy help?
 - Stop phone calls and letters?
 - No-contact letters
 - Pay back debts?
 - Because they can or because they feel like they have to?
 - Avoid having a judgment entered?
 - Because they worry about their credit? Garnishment? Levy?
 - Protect income or other assets?
 - Are they already protected?
 - Could bankruptcy end up putting the assets at-risk?
 - "Repair" or "fix" credit?
 - To get into more debt?
 - Because Credit Karma tells them they need "good" credit?
 - "Save" their home?
 - Can they afford to pay?

Pre-filing Counseling

- Will bankruptcy will have unintended consequences
 - Are there unprotected assets the debtor can lose?
 - Home equity over \$600,000.00?
 - A car with significant equity?
 - Significant non-retirement account savings?
 - Has there been a transfer of property in recent years?
 - A car to a child?
 - Adding someone to title of home?
 - Will the debtor likely incur debt after bankruptcy?
 - Post-petition debt cannot be "included" in the filed bankruptcy
 - Can the debtor make rent payments? Car payments?
 - Bankruptcy does not "create" income
 - If someone cannot afford their necessary expenses, they should not file for bankruptcy

A Note About "Fixing" or "Cleaning Up" Credit

- Bankruptcy does not "fix" credit. Really, nothing can except time.
- A bankruptcy does not "clean up" a credit report
 - All tradelines continue to be reported; they add a notation of "in bankruptcy" or "discharged in bankruptcy"
 - Landlords, banks, lenders, etc. will still see the prior debts
 - Defaulted debt will drop off the credit report seven years and 30 days after the last payment
 - Filing for bankruptcy ADDS a negative report - the bankruptcy itself
 - Stays on for 10 years
- A person in bankruptcy will get credit offers
 - No discharge for another eight years
 - Terrible terms
- It takes between two and four years after a bankruptcy to recover credit-wise

Pre-filing Investigation

- If debtor still wishes to file, obtain additional information and review for any red flags:
 - State or Federal tax debt
 - Only dischargeable if the debtor filed the return, the return was due at least three years before filing bankruptcy, the taxes were assessed more than 240 days before the bankruptcy filing, and no fraud
 - Does not remove recorded tax liens
 - Large deposits or withdrawals of unclear origin
 - Trustee may assume a preferential or fraudulent transfer
 - Has the debtor EVER used a social security number that was not provided by the federal government
 - Whether to work or obtain credit - the petition clearly asks for all SSNs every used.
 - The debtor can be referred to the Department of Justice
 - Has the debtor used a social security number that was for employment authorization only to obtain credit

Pre-filing Investigation

- Review information for any red flags:
 - Storage unit debt
 - Likely a secured debt and bankruptcy will not get items back
 - Unable to make car payments/behind
 - Finance company may seek leave to repossess during bankruptcy
 - Unable to make regular rent/utility/necessities payments
 - Likely to incur more debt after filing
 - Bankruptcy filed in last eight years
 - Only eligible for a discharge once every eight years
 - "Significant" assets
 - Home with close to or more than \$600K equity; new or used car with more than \$9K-\$30K equity; or title to parents' home or bank accounts
 - Recent moves to or from California or within different districts in California
 - Venue and exemptions matter

Pre-filing Counseling

- If bankruptcy appears to be appropriate, advise the debtor to gather documents (to start)
 - Bankruptcy intake;
 - Tax returns for the past two years (or tax returns from the most recent year in which the debtor filed taxes);
 - Paystubs or proof of any other income for the last six (6) months (this includes Social Security payments, unemployment benefits, food stamps, CalWorks, etc.);
 - If the debtor is self-employed, gets paid in cash, or their income varies, bank statements for the last six (6) months;
 - Most recent credit reports from all three credit bureaus (Transunion, Equifax, Experian);
 - Bills, statements, invoices and collection letters for all debts for the last month; and
 - Any lawsuits

Chapter 7 Process

- Debtor prepares [Chapter 7 petition](#) (86 pages)
- Debtor completes pre-petition credit counseling course
- Debtor files petition and pays \$338 (or applies for a fee waiver or request to pay in installments)
 - Bankruptcy estate is created, a trustee is appointed, and the automatic stay is in effect
- Debtor gets a date for 341(a) hearing (meeting of the creditors)
- Debtor attends 341(a) hearing
- Debtor files post-petition financial management course
- If debtor received a reaffirmation agreement and returned it, debtor appears at reaffirmation hearing
- Court grants discharge and closes case

Chapter 7 Process - 341(a)

- 341(a) Hearing
 - Takes about two minutes
 - Run by the case (Chapter 7) trustee
 - Debtor must review the [Bankruptcy Information Sheet](#)
 - If interpretation is needed, debtor can request free interpreter
 - Trustee asks for original social security card and ID and asks series of [questions](#)
- Even though it's called a meeting of the creditors, the only creditors that show up tend to be:
 - Exes (ex-spouse, ex-friend, ex-business partner)
 - The IRS (← and if they show up, good luck)
 - The United States Trustee (← and if they show up, good luck)

Chapter 7 Process - Reaffirmation

- If a debtor has a secured debt, they must complete the [Statement of Intention](#)
- They can choose to:
 - Surrender the property - return it
 - Useful if the debtor no longer wants the property; personal liability is discharged
 - Retain the property and redeem it - pay the fair market value
 - Useful if the FMV is far less than what is owed and the debtor can find a way to pay the FMV; personal liability is non-existent
 - Retain the property and reaffirm it - maintain personal liability
 - Creditor can take the collateral AND sue for deficiency if reaffirmed
 - "Other" - this is not really an option these days

Chapter 7 Process - Reaffirmation

- If the debtor is *Pro Se* or their attorney does not believe the reaffirmation is in the debtor's best interest, the reaffirmation is set for hearing
 - Judge determines whether it is in the best interest of the debtor by looking at:
 - Interest rate
 - Monthly payment
 - How much time is left on the loan
 - Is the collateral worth much less than is owed
 - If it's a vehicle, is the debtor driving the car or is it a car someone else drives
 - Is the debtor current on payments
 - Based on monthly income and expenses, is the loan affordable
- Why?
 - All other dischargeable debts in bankruptcy release personal liability. Reaffirming the debt "replaces" the personal liability. It's as if you never filed bankruptcy on this debt

Chapter 7 Process - The Discharge

- Upon completion of the bankruptcy, the court will order a discharge of "all dischargeable debts"
 - There is no list
- Generally speaking, the discharge automatically does not apply to student loans, domestic support obligations, certain criminal/government fines and fees
- Collection actions taken against the debtor on dischargeable debts can give rise to contempt motion for violation of the discharge injunction
- If debtor has filed an adversary proceeding to determine the dischargeability of other debts, if granted the discharge injunction applies
