

Bankruptcy

This handout discusses bankruptcy issues military members and their dependents may face. Discussion can only be in general terms since this is a complex area and the law changes often. Although military attorneys do not practice bankruptcy law, the following discussion should provide some insight into the process. After reading this handout, an individual will be better prepared to discuss this issue with a private attorney specializing in bankruptcy law, should the individual decide bankruptcy is a viable alternative.

1. **WHAT IS BANKRUPTCY?**

a. Bankruptcy is a legal proceeding where a debtor goes to court to have his or her obligations modified or forgiven when the debtor cannot meet his or her obligations after the debtor has honestly made a diligent effort to pay the obligations. The goals of bankruptcy are to (1) convert the assets of the debtor into cash and distribute it among creditors fairly and (2) give the debtor a fresh start, with such exemptions (property the debtor can keep) and rights as the bankruptcy laws permit.

b. The United States Constitution gives Congress the power to make one set of bankruptcy rules for the entire country. Thus, when a debtor files for bankruptcy, the debtor is receiving federal protection from his or her creditors. Consequently, a bankruptcy proceeding must be filed in specially created federal bankruptcy courts.¹

2. **NONBANKRUPTCY ALTERNATIVES:** Before filing for bankruptcy, you should consider other means of solving your financial problems. For example, you should consider making an appointment with the base Financial Counselor at 283-2177. The services are free. Aside from helping you establish a monthly budget, the Counselor can discuss money-saving techniques, such as the following:

a. Stop the Cash-Flow Drain: Many times individuals own property they cannot afford. For example, a young airman may have bought a very expensive vehicle, which causes the airman to make high monthly payments. In cases where the individual is living beyond his or her means, it is preferable the individual sell or return the expensive property instead of filing for bankruptcy.

b. Negotiated Work-Outs: Sometimes creditors are willing to enter into a negotiated settlement with you if they believe you are simply not able to pay them back the entire amount. They may be willing to settle for much less than the full amount, such as getting 50 cents on the dollar. A consumer credit counseling agency may also provide some assistance for a "small" fee.

c. Consolidation Loan: Sometimes obtaining a loan from a financial institution may be beneficial in that by paying off your debts in one lump sum, you avoid all the high interest payments you usually make on all your debts, such as in the case with credit card companies. If you cannot obtain such a loan from a bank, you should consider asking family members and agreeing (in writing) to pay them back, either at no interest or at a minimal interest rate.

3. **TYPES OF BANKRUPTCY AVAILABLE:** Generally, four different types of bankruptcy exist. They are referred to by their chapter number in the Bankruptcy Code.

a. Chapter 7: This is also referred to as "straight bankruptcy" or "liquidating bankruptcy" because the court takes most of the debtor's property, sells it, divides the proceeds among the creditors, and discharges

¹ <http://www.flmb.uscourts.gov/bankruptcybasics/documents/bankruptcybasics.pdf>

the remaining debts. Chapter 7 bankruptcy is discussed in further detail below.

b. Chapter 11: Provides relief for business debtors or certain individual debtors by permitting the debtor to propose a plan of reorganization subject to creditor and court approval.

c. Chapter 12: Provides relief to the family farmer.

d. Chapter 13: This is also referred to as the "wage earner's plan" because the court approves a realistic plan where the debtor can retain much of his or her property in exchange for paying back the debts over a period of time, ranging from three to five years. The debtor must have regular income to be able to complete the plan. This type of bankruptcy can only be used by individual debtors, and only if the total debts owed are less than certain limits. Chapter 13 bankruptcy is discussed in further detail below.

This handout will mainly discuss filing for Chapter 7 and Chapter 13 bankruptcy, as they are the ones most typically used by military members.

4. **CHAPTER 7**

a. Purpose: In this type of bankruptcy proceeding, the debtor surrenders all the property the debtor owns, except the exempt property. In exchange, the debtor is no longer required to pay his or her debts and the creditors are barred from further collection activity. Since there is usually little to no nonexempt property in a Chapter 7 filing, there may not be a liquidation of the debtor's assets. Creditors with non-secured claims will typically receive a distribution from the liquidation only if the case contains assets to be liquidated and the creditor files proof of claim with the Court.² A typical Chapter 7 debtor will not appear in court or see the bankruptcy judge unless an objection is made in the case. A debtor should consider filing under this chapter if the debtor is simply being overwhelmed with all the debts and it is unlikely the debtor can ever pay back all that is owed. Depending on the jurisdiction, the debtor may be required to attend a court-approved personal financial management course prior to the judge approving the bankruptcy. (11 U.S.C. § 727 (a)(11). Other reasons for denial of discharge can be found at 11 U.S.C. 727(a), including fraud, concealment of property, false accounts of the estate and willfully disobeying any lawful order of the Bankruptcy court. A Chapter 7 discharge is only available to an individual debtor, not a partnership or corporation. Some types of debts are not discharged and Chapter 7 does not extinguish a lien against property of the debtor.

b. Nondischargeable debts: To determine whether the debtor should file for bankruptcy and, if so, what type of bankruptcy, the debtor needs to know which debts cannot be discharged (i.e., debtor no longer has to pay). The following are a list of some of the debts which the debtor cannot avoid paying (11 U.S.C. §523):

- i. Taxes
- ii. Child Support
- iii. Maintenance or Alimony (as opposed to property settlement)
- iv. Property obtained by false pretenses
- v. Student loans guaranteed by a government institution, unless it will impose an undue hardship on the debtor and the debtor's dependents
- vi. For willful and malicious injury by the debtor to another entity or to the property of another entity
- vii. For death or personal injury caused by the debtor's operation of a motor vehicle if such

² <http://www.flmb.uscourts.gov/bankruptcybasics/documents/bankruptcybasics.pdf>

operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance

- viii. For fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny
- ix. Debts scheduled by debtor in a prior bankruptcy in which the debtor waived discharge or was denied discharge for grounds other than having previously filed bankruptcy within 6 years
- x. Debts not listed or scheduled in the case which are insufficient to permit the omitted creditor from filing a proof of claim. **IMPORTANT! You must list all debts!!!**

c. Means testing: Starting in October 2005, a person's income must be below the median income for the same-size family in their state of residency to file under Chapter 7. If the debtor's monthly income is more than the state median, the Bankruptcy Code applies a "means test" to determine whether the Chapter 7 filing is abusive. Abuse is presumed if the debtor's monthly income, minus certain expenses, is more than \$11,725 or more than 25% of the non-priority unsecured debt, as long as that amount is at least \$7,025. If the debtor is unable to rebut this presumption of abuse by a showing of special circumstances, the case will generally be converted to a Chapter 13 filing or will be dismissed. Certain disabled veterans, Reservists, and National Guard members may be exempt from means testing.

d. Limit on filing: If the debtor has received a Chapter 7 discharge within the preceding 8 years, then the debtor is barred from filing another Chapter 7 bankruptcy. (11 U.S.C. §727(a)(8)).

e. Secured Property: It is important to note that although a Chapter 7 discharge may destroy the debtor's obligation to pay the debt to the secured creditor, it does not destroy the secured creditor's right to repossess its collateral. Thus, the home and car can be foreclosed and repossessed if the debtor does not continue making mortgage and car payments.

5. CHAPTER 13

a. Purpose: The debtor can retain most of the property he or she owns that is nonexempt in exchange for paying the creditors over a 3 year period (or 5, for good cause or for people whose income exceeds the median). To qualify, the debtor must have regular income to pay the debts over this period of time. The trustee and creditors must approve the debtor's plan to pay them a certain amount over a period of time. Thus, the debtor must propose a realistic yet honorable payment plan to reimburse the creditors. Chapter 13 works as follows: Minus basic living expenses and any payments owed on a secured debt, such as a home loan, the debtor turns over all non-essential income to the court in the form of a monthly payment. The trustee then distributes it to creditors. Sometimes the court will issue an earnings deduction order to the Accounting and Finance office so a portion of the member's pay will go to the trustee for distribution to creditors. One of the advantages of a Chapter 13 filing is that it can prevent the debtor's home from being foreclosed upon, provided the debtor cures delinquent mortgage payments via the debt repayment plan and continues to make regular monthly payments during the repayment period. Chapter 13 also allows the debtor to reschedule other secured debt payments during the course of the debt repayment plan. A typical Chapter 13 debtor may only have to go before the bankruptcy judge at a plan confirmation hearing. In addition, the only formal proceeding that a Chapter 13 debtor must appear at is a meeting of creditors, where creditors can question the debtor about debts and property. This is a required meeting pursuant to Section 341 of the Bankruptcy Code.

b. Eligibility: Any individual, even if self-employed or operating an unincorporated business, is eligible for Chapter 13 relief as long as the individual's unsecured debts are less than \$360,475 and secured debts are less than \$1,081,400. 11 U.S.C. § 109(e).³ These figures are adjusted periodically to reflect

³ <http://www.flmb.uscourts.gov/bankruptcybasics/documents/bankruptcybasics.pdf>

changes in the consumer price index. A debtor cannot file under Chapter 13 if a petition was dismissed within the preceding 180 days due to misconduct on the part of the debtor.11 U.S.C § 109(g).

c. Nondischargeable debts: A Chapter 13 debtor may obtain a discharge under two conditions. Either the debtor completes all payments required under the plan (and receives a discharge as to the debts which the plan specified would remain unpaid) or, if the debtor is unable to complete all payments required by the plan, the debtor will seek a "hardship" discharge, pursuant to 11 U.S.C. §1328(b). Because a hardship discharge under Chapter 13 is not as broad as one under Chapter 7, it may be wise to convert the proceedings into a Chapter 7. Generally, a discharge under Chapter 13 is broader than one under Chapter 7. Under a normal Chapter 13 proceeding, the debtor will not be able to discharge the following debts:

- i. Alimony, maintenance, or child support (11 U.S.C. §1328 above)
- ii. Student loan (as described in Chapter 7 above)
- iii. For death or personal injury (as described in Chapter 7)
- iv. Debts incurred by fraudulent representations to obtain credit
- v. Installment debts where the last scheduled payment falls outside the date of the Chapter 13 discharge

d. Limit on Filing: If the debtor has been granted a discharge in a prior Chapter 13 case filed within the last 6 years, under which less than 70% of the unsecured claims were paid, then the debtor will not be able to file a Chapter 7 bankruptcy, although the debtor may be able to file another Chapter 13 bankruptcy.

6. FLORIDA EXEMPTIONS

Irrespective of whether a debtor files for Chapter 7 or Chapter 13 bankruptcy, the Bankruptcy Code provides that some of the debtor's property is exempt (the member gets to keep it) so the debtor can have a "fresh start." The Code permits each state to opt out of the federal exemptions, in which case the only exemptions available to the debtor would be those afforded by state law and by non-bankruptcy federal law. Florida opted out and established its own exemptions. In order to use Florida exemptions, a debtor must be domiciled in Florida for a minimum of 730 days prior to filing the petition. Debtors are allowed to exempt their homes from being considered in bankruptcy proceedings. Florida has one of the more generous homestead exemptions, allowing for an unlimited amount of value in the home or other property covered by the homestead exemption. The property cannot be larger than a half acre in a municipality or 160 acres elsewhere. Additionally, the debtor is required to have owned the exempted property for at least 1,215 days prior to the filing. If this requirement can't be met, the homestead exemption is limited to \$146,450.⁴ Consult your attorney about the current status of this and other exemptions.

7. CONSIDERATIONS IN FILING CHAPTER 7 OR CHAPTER 13

a. Ability to make payments: The debtor has to make a realistic assessment of his or her ability to make payments. The court will first look at the debtor's "current monthly income" which includes the average of income derived from all sources, whether taxable or not, during the preceding 180 days. If the debtor has regular income and can make payments and not be overwhelmed, then a Chapter 13 may be better. Otherwise, a Chapter 7 may be better.

b. Dischargeability of certain debts: The debtor needs to see under which type of discharge the debtor gets the most debts discharged.

⁴ Fla. Stat. Ann § 222

c. Amount of non-exempt property: If most of the debtor's property is exempt, then Chapter 7 may be most beneficial. Otherwise, Chapter 13 allows the debtor to keep most of the non-exempt property.

d. Desire to pay creditors: Once the debtor has stated what he/she is going to do, he/she has 45 days within which to perform redemption, reaffirmation or assumption, or the automatic stay from creditor collection is terminated with respect to personal property.

e. Co-debtors or guarantors: If members of your family co-signed for you and you want to protect them, then Chapter 13 is preferable since co-signers and guarantors are protected under the automatic stay. It appears this cannot be accomplished under Chapter 7.

f. Desire to reestablish credit: You should note that debtors filing for bankruptcy may have difficulty getting credit from major lenders, as bankruptcy filings are noted by commercial credit reporting companies. Debtors get a 10-year negative mark on credit agency reports and, under some circumstances, may have an ongoing battle with creditors who are looking for any slip-ups as an excuse to seize their assets. However, sometimes creditors will look more favorably to someone who makes an attempt to pay his or her debts under a Chapter 13 plan than someone who opts for Chapter 7. This may be true if the debtor can pay close to 100% of the debt.

g. Default on Secured Property: If a debtor is in default on property which the debtor wants to keep, Chapter 13 may permit the debtor to cure the default and keep the property. For example, by filing under Chapter 13, debtors can stop foreclosure proceedings and may cure delinquent mortgage payments over time. However, they must still timely pay all mortgage payments that come due during the Chapter 13 plan.

BASIC STEPS FOR FILING FOR CHAPTER 7 OR CHAPTER 13 BANKRUPTCY:

a. Credit Counseling: To initiate the process, you must undergo consumer credit counseling with an approved non-profit counseling service and obtain a certification indicating that you have received such counseling (11 U.S.C. §§109, 111). You must also complete a personal financial management course within 45 days after the date first set for the creditors' meeting.

b. Petition: You must also file a bankruptcy petition in the appropriate federal court. Florida has 3 federal district courts, each of which has a U.S. Bankruptcy Court. Although you are not legally required to have an attorney to file, it may be extremely helpful to have one since this is an extraordinarily complex area of the law.

c. Schedules: You are required to file schedules and a statement of financial affairs with the petition. These schedules must list all the debtor's creditors, as well as the debtor's assets, liabilities, property, income, and expenditures. It is absolutely essential to list all debts, as failure to list a debt can mean you still are liable for it after your other debts are forgiven! Married debtors must gather this information for their spouse, regardless of whether they are filing a joint petition, separate petitions, or if only one spouse is filing. All debtors must also submit a copy of the most recent tax year's tax return, as well as any tax returns filed during the case, to the United States Trustee.

d. Where to File Petition: Pursuant to 28 U.S.C. §1408, the petition is properly filed with the Bankruptcy Court in the district in which the domicile, residence, principal place of business or principal

assets of the debtor have been located for the greater part of 180 days immediately preceding the filing of the petition.

e. Appointment of Trustee: Once the Office of the Clerk of the Bankruptcy Court in the district in which the debtor filed receives the petition, the clerk will appoint a disinterested member, from a panel of individuals approved as trustees, to serve as an "interim trustee." The trustee will then collect all of the debtor's non-exempt property from the debtor and manage it on behalf of the creditors until the bankruptcy proceedings are terminated.

f. Court Grants an Automatic Stay: Once the Clerk receives the petition, the Clerk will issue a notice to all the creditors (listed by the debtor in the petition) informing them they are prohibited from attempting to collect their debts. (11 U.S.C. §362). An automatic stay is a very valuable form of relief because it can block foreclosure on a mortgage, repossession by secured creditors, and it can even block action by the IRS. If a creditor violates the stay order, then the debtor can petition the court for damages, costs, attorney's fees and punitive damages. However, certain legal actions against the debtor cannot be stayed:

- i. Initiation or continuation of a criminal law suit
- ii. Collection of alimony, maintenance, or support
- iii. Protesting the dishonoring of a check in the bank

The creditor can also request the court to "lift the automatic stay" when there is a "lack of adequate protection." This can occur when the debtor is holding property which is collateral for a secured creditor's claim and the property is depreciating, or is inadequately insured or cared for, and the debtor is not making any payments. Generally, if the stay is not lifted, this protection lasts until the bankruptcy proceedings are over.

g. Creditors' Meeting: Within a reasonable time after the order for relief, the trustee will schedule a meeting of creditors (also known as a "341 meeting"), pursuant to 11 U.S.C. §341. This enables the creditors to examine the debtor under oath as to any questions raised in the debtor's petition or schedules. Generally, the trustee begins by asking the debtor to confirm he or she read the petition and was truthful as to all matters. After the trustee asks questions, the creditors get their turn, if they appear. At this meeting, the creditors can elect a permanent trustee. (11 U.S.C. §702).

Creditors generally get paid first according to the following order:

- i. those that are priority claims (generally, non-dischargeable debts);
- ii. secured creditors (where a lien exists on property to ensure the loan is paid); and
- iii. unsecured creditors (where no such lien exists guaranteeing payment of the loan). A debtor with secured debts must tell the court, right after filing the petition, what he or she will do with those debts. (11 U.S.C. §521). Generally, the debtor has 4 options:

- (1) surrender the property;
- (2) redeem the property (11 U.S.C. §722) by paying the balance owed on it;
- (3) reaffirm the debt by entering into a reaffirmation agreement (11 U.S.C. §524c) with the secured creditor, subject to approval of the court; or
- (4) enter into an informal agreement with the creditor where the debtor agrees to keep payments up to date and creditor agrees not to repossess the property.

h. Discharge: The debts the debtor listed in the petition will be "discharged" (forgiven) when the debtor

successfully completes the Chapter 7 or Chapter 13 bankruptcy plan. This is the goal of filing for bankruptcy.

8. **WAYS TO LOSE A BANKRUPTCY**

- a. Falsification, concealment, or failure to preserve financial records
- b. Fraudulent transfer, concealment, or wasting of property within a year before filing petition
- c. Fraud, misrepresentation, or misconduct involved in the filing of the bankruptcy
- d. Failure to explain satisfactorily any loss of assets or deficiency of assets
- e. Refusal to obey any lawful order of the court
- f. Refusal to cooperate
- g. Prior Chapter 13 discharge within 6 years unless the plan was proposed in good faith and 70% of the unsecured claims were paid
- h. Not listing all your creditors!!! If you fail to list them, then those debts are still owed and you will have gone through much expense, time, and hardship without getting the fresh start you wanted.

9. **MILITARY CONSIDERATIONS:** Section 525 of the Bankruptcy Code provides that no governmental unit may discriminate with respect to employment because an individual has filed for bankruptcy. While a service member has a right to file for bankruptcy, a member can be discharged or prosecuted under Article 134 of the Uniform Code of Military Justice for "dishonorable failure to pay just debts." However, action will likely be taken only if it is determined the member is not acting in good faith. Additionally, a commander has discretion to restrict or withdraw access to classified information whenever a military member's financial situation makes the member vulnerable to bribes or blackmail. Loss of access is by no means automatic.

10. **SERVICEMEMBERS' CIVIL RELIEF ACT (SCRA):** The Servicemembers' Civil Relief Act (SCRA) is found at 50 U.S.C. app. §§501 et seq. The primary purposes of SCRA re to (1) provide service members protection against default judgments; (2) implement a stay of proceedings where proceedings against the service member have been initiated; and (3) stay or vacate execution of judgments, garnishments, or attachments. A service member may invoke the protections of SCRA in any bankruptcy presented before the bankruptcy court, including any default judgments levied therefrom. One condition for invoking SCRA protection is that the bankruptcy court clerk's office must be made aware of the member's military status y the plaintiff prior to the default judgment against the defendant military member.

11. **LEGAL ASSISTANCE FOR FILING:** The debtor will likely need the help of an experienced attorney in the area of bankruptcy law. As military attorneys, we are prohibited by regulation from representing individuals before courts or drafting such documents. You should consider contacting the following sources:

a. Legal Aid: Generally, Legal Aid is a state agency which provides free legal representation to individuals who usually fall within the poverty level. For more information, please contact them at (850) 862-3279, Monday – Thursday from 8:30 am to 5:15 pm.

b. Attorney Referral Service: This is a state-wide service which will find a bankruptcy attorney for you in your local area. There is a \$25 fee for a 30 minute consultation. For certain low income individuals, this fee can be either reduced or waived. You can contact them at 1-800-342-8011.

WARNING! *The information provided here is very general. You should consult with an expert in the field of bankruptcy to make a final determination whether to file and how to proceed. Also, this information was obtained from various sources, including: (1) Bankruptcy Overview For Legal Assistance Attorneys by Mr. David D. Lemmon (1992) and (2) Bankruptcy in a Nutshell by Maj James L. Birkel and Capt Mark S. Cohen (1987). The material in this handout represents general legal advice. Since the law is continually changing, some provisions in this pamphlet may be out of date. It is always best to consult an attorney about your legal rights and responsibilities regarding your particular case.*