

Bankruptcy as a Remedy for Individuals with Primarily Consumer Debts

I. The ABCs of any bankruptcy case

A. Exemptions:

Property a debtor can keep if they want a bankruptcy discharge. (If the debtor only wants a repayment plan and is not requesting that any debts be discharged, you don't have to worry about exemption limits.)

- Found at 11 U.S.C. § 522(d)
- If a spouse or both spouses file, they each get the entire exemption amount, and only have to exempt a one-half interest in marital property.

B. Three types of debt:

1. Secured (Mortgages, car loans, anything secured by a lien)
2. Priority unsecured (taxes, support)
3. Non-priority unsecured (credit cards, medical bills)

C. Automatic Stay

- 11 U.S.C. § 362 provides that, upon filing a bankruptcy petition, all collection activity must stop. This includes execution sales, garnishments, evictions, repossessions and utility shut-offs.
- Creditors must seek relief from the stay in order to proceed (unless automatically lifted).

D. Means Test:

A debtor, other than a disabled veteran, reservist or National Guard, whose monthly income is more than the median income for a family of their size in PA may have to prove that there are special circumstances which entitle them to relief. There is a formula, called the Means Test, that compares their monthly income, less specified deductions, to their non-priority unsecured debt. This test is meant to determine whether or not they can pay their otherwise dischargeable debt. Current median incomes are:

<u>Family Size</u>	<u>Median Income Limit</u>
1	\$51,138
2	\$61,271
3	\$75,018
4	\$90,821

II. Protecting Income

1. Wage garnishment

- a. Landlord/tenant judgments: Pa.R.C.P. No. 3301-3304 & 42 Pa.C.S. § 8127
In PA, a judgment will allow landlords to garnish wages under certain circumstances. A landlord's judgment is dischargeable unless the landlord can prove "willful and malicious injury" as defined in 11 U.S.C. §§ 523(a)(6) and 1328(a)(4).
- b. Priority debts: 11 U.S.C. § 507
Wages can also be garnished to collect domestic support obligations, unpaid income taxes, student loans, and criminal restitution, and these debts are typically not dischargeable, but debtors can use Chapter 13 to pay priority debts over time in a plan. If the debtor commits all of his/her "disposable income" to the plan, the debts need not be paid in full, but will not be discharged.
- c. Avoiding Preferences: 11 U.S.C. § 547
You can sometimes recover income that was garnished in the 90 days before the bankruptcy was filed, even if the government is the creditor, unless the debt was a domestic support obligation. You must show that the creditor would not receive that money in a liquidation (i.e. all property is exempt or non-exempt property would be distributed among several creditors). The preference must be \$600 or more.

2. Recoupment of overpayments

- a. Benefit overpayments are dischargeable, unless the government can prove the overpayment was caused by false pretense or fraud. Usually the amount recouped in the 90 days prior to the petition is less than \$600, but if not, you can attempt to avoid the transfer as a preference.
- b. False Pretense or Fraud: 11 U.S.C. § 523(a)(2)
A creditor can file a complaint seeking a determination by the court that the debt was the result of the debtor's false representation or fraud and is therefore nondischargeable. The burden is the on creditor.

3. Tax refund intercept

- a. Preferences: 11 U.S.C. § 547
You can recover a tax refund that was intercepted in the 90 days before the bankruptcy was filed, as long as it was not intercepted for a domestic support obligation. You must show that the creditor would not receive any or all of the money in a liquidation (i.e. all property is exempt or non-exempt property would be distributed among several creditors). This usually happens due to a delinquent student loan. The preference must be \$600 or more.

III. Protecting Assets

1. Non-Exempt assets

- A debtor can propose, in a Chapter 13 plan, that they will liquidate a non-exempt asset and use the proceeds to pay outstanding debts. See 11 U.S.C. § 1322(b)(8).
- This helps a debtor to avoid an execution sale where they would receive far less than fair market value for the property.

2. Lien avoidance: 11 U.S.C. § 522(f)

- A judgment can be avoided to the extent that it impairs an exemption.
- Possessory or purchase-money security interests cannot be avoided

3. Right to cure: 11 U.S.C. § 1322(b)(5)

- Chap. 13 allows debtors to cure defaults in 3 to 5 years. Mortgages, purchase-money security interests, statutory liens and any other liens that cannot be avoided, stripped or crammed down can be paid through a plan.
- Especially useful to cure tax debts, municipal liens, mortgages, and PMSI car loans.

4. Modification of Certain Secured Debts: 11 U.S.C. §§ 1322(b)(2) and 1325

- Also referred to as stripping or cramdown
- Secured debts that cannot avoided or discharged might be reduced or stripped off completely if the collateral is worth less than the amount owed. The unsecured portion is stripped off or crammed down, so the debtor only has to pay the secured portion.
- 1322(b)(2) allows the court to "modify" the debt, which could mean lower principal (cramdown), lower payments, deferred payments, change in term, eliminating oppressive terms, eliminating liens (stripping).
- The court limits modification to Chap. 13 organizations. See Cook v. IndyMac Bank, FSB (In re Cook) 449 B.R. 664 (U.S. Dist. N.J. 2011)
- Limitations:
 - a. Mortgages: Debts secured by real property that is only used as the debtor's principal residence cannot be stripped, unless the mortgage is also secured by other property or is completely unsecured or the final mortgage

payment will be due during the plan. (Mobile homes not on a foundation are not considered real estate.)

b. Purchase-Money Security Interests in a vehicle, if incurred within 910 days for the personal use of debtor.

- **Mortgage Modification Mediation Program:** L.B.R. No. 9019-3. Only for principal residence. Creditor must agree to participation. Debtor must make post-petition payment of 75% of regular monthly payment.

5. Redemption: 11 U.S.C. § 722

- Debtor can redeem and reclaim property that has been repossessed
- Must redeem or file bankruptcy within the redemption period
- UCC gives right to redeem until collateral sold (or contracted for disposition)
- Motor Vehicle Sales and Finance Act gives right to redeem 15 days from date of mailing post-repossession notice.
- If debtor can't redeem by paying accelerated debt, should file Chap 13 and propose cure.

6. Setting aside sales: 11 U.S.C. §§ 547 and 548

- a. Debtor must prove preferential transfer (547) or fraudulent conveyance (548), which can be very difficult to do.
- b. Preferential transfer (i.e. the creditor purchased the property and benefited more than it would have in liquidation in 90 days before petition). If it's a secured creditor with priority, probably did not benefit more than it would have in liquidation. **If it is an unsecured creditor and the property was sold within 90 days prior to the petition, the transfer is probably avoidable.**
- c. Fraudulent transfer (transferred for less than reasonably equivalent value within two years before petition). Sounds promising, but court often assumes that a properly conducted sale = reasonably equivalent value.
- d. Major limitations on this option include:
 - i. Court's belief that a properly conducted sheriff sale or tax sale results in reasonably equivalent value.
 - ii. Good faith transferee has a lien on the property recovered
 - iii. Creditor might have received the same in a liquidation

IV. Protecting Utility Service

- A. A utility cannot terminate service within the first 20 days of bankruptcy.
- B. Discharge or cure?
 1. Municipal utility debts cannot be discharged and must be cured in Chap. 13. See 53 P.S. § 7106.
 2. Statutory liens that cannot be avoided must be cured.
 3. All other utility debts are dischargeable.
- C. Service: The utility cannot refuse service upon filing or discharge. They can only demand a security deposit as allowed by law.
- D. Customer Assistance Programs – if your client is participating in a CAP and files bankruptcy, they will be removed for the program and asked to pay a security deposit.

V. Driver's license suspensions

We often see clients whose licenses were suspended after a motor vehicle accident and will not be reinstated until the debt is paid. Discharging the debt in bankruptcy will allow their license to be restored. Debts incurred as a result of impaired driving are not dischargeable. See 11 U.S.C. § 523(a)(9).

VI. Evictions

- Bankruptcy can be vital to public housing tenants and mobile home owners, most of whom can only be evicted for good cause, not for end of the lease term. A bankruptcy will allow them to cure the default in rent payment and may even allow a cure of non-monetary defaults.
- If a landlord has the right to terminate a lease at the end of its term, bankruptcy will only allow the tenant to stay until that time.
- If there is a judgment for possession, and it hasn't been appealed, a bankruptcy petition will only stay an eviction for 30 days, and only if the tenant has the "pay and stay" option (the right to cure under state law) and deposits one month's rent with the bankruptcy court. Then the tenant must cure the default within those 30 days.
- If there is no judgment for possession, or the judgment has been appealed, the automatic stay stops an eviction, and the landlord will have to seek relief from the stay to proceed.

- Use Chapter 13 if debtor needs time to cure. In 13, the debtor can "assume" the lease and cure it. The lease must be unexpired and debtor must cure "promptly" or provide adequate assurance that it will be cured promptly. This will usually be disputed. Also expect disputes over the existence of a curable default and existence of lease or term of lease. § 1322(b)(7)
- In Chapter 7, only the trustee can "assume the lease" and might choose to reject it, since the purpose of a Chapter 7 is liquidation, not reorganization.

VII. Protection against Debt Discrimination

- Governmental units cannot discriminate on the basis of a bankruptcy filing. 11 U.S.C. § 525(a). Housing authorities, public and municipal utilities and government-backed student loan lenders cannot deny benefits to a client based upon previously discharged debt.
- Private employers cannot make the decision to hire or fire based upon discharged debt.

13

Bankruptcy Exemptions

11 USCS § 522

(d) The following property may be exempted under subsection (b)(2) of this section:

(1) The debtor's aggregate interest, not to exceed \$ 23,675 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a **RESIDENCE**, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor.

(2) The debtor's interest, not to exceed \$ 3,775 in value, in one **MOTOR VEHICLE**.

(3) The debtor's interest, not to exceed \$ 600 in value in any particular item or \$ 12,625 in aggregate value, in **HOUSEHOLD FURNISHINGS, HOUSEHOLD GOODS, WEARING APPAREL, APPLIANCES, BOOKS, ANIMALS, CROPS, OR MUSICAL INSTRUMENTS**, that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

(4) The debtor's aggregate interest, not to exceed \$ 1,600 in value, in **JEWELRY** held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

(5) The debtor's aggregate interest in **ANY PROPERTY**, not to exceed in value \$ 1,250 plus up to \$ 11,850 of any unused amount of the exemption provided under paragraph (1) of this subsection.

(6) The debtor's aggregate interest, not to exceed \$ 2,375 in value, in any **IMPLEMENTS, PROFESSIONAL BOOKS, OR TOOLS, OF THE TRADE** of the debtor or the trade of a dependent of the debtor.

(7) Any unmaturred **LIFE INSURANCE** contract **owned by the debtor**, other than a credit life insurance contract.

(8) The debtor's aggregate interest, not to exceed in value \$ 12,625, less any amount of property of the estate transferred in the manner specified in section 542(d) of this title [11 USCS § 542(d)], in any accrued dividend or interest under, or loan value of, any unmaturred **LIFE INSURANCE** contract owned by the debtor under which **the insured is the debtor** or an individual of whom the debtor is a dependent.

(9) Professionally prescribed **HEALTH AIDS** for the debtor or a dependent of the debtor.

(10) The debtor's right to receive--

(A) a **SOCIAL SECURITY** benefit, **UNEMPLOYMENT** compensation, or a local **PUBLIC ASSISTANCE** benefit;

(B) a **VETERANS' BENEFIT**;

(C) a **DISABILITY, ILLNESS, or UNEMPLOYMENT BENEFIT**;

(D) **ALIMONY, SUPPORT, or SEPARATE MAINTENANCE**, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(E) a payment under a **STOCK BONUS, PENSION, PROFITSHARING, ANNUITY, OR SIMILAR PLAN** or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor, unless—

(i) such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the debtor's rights under such plan or contract arose;

(ii) such payment is on account of age or length of service; and

(iii) such plan or contract does not qualify under section 401(a), 403(a), 403(b), or 408 of the Internal Revenue Code of 1986 [26 USCS § 401(a), 403(a), 403(b), or 408].

(11) The debtor's right to receive, or property that is traceable to--

(A) an award under a **CRIME VICTIM'S REPARATION** law;

(B) a payment on account of the **WRONGFUL DEATH** of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(C) a payment under a **LIFE INSURANCE** contract that insured the life of an individual of whom the debtor was a dependent on the date of such individual's death, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(D) a payment, not to exceed \$ 23,675, on account of **PERSONAL BODILY INJURY**, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent; or

(E) a payment in compensation of **LOSS OF FUTURE EARNINGS** of the debtor or an individual of whom the debtor is or was a dependent, to the extent

reasonably necessary for the support of the debtor and any dependent of the debtor.

(12) **RETIREMENT FUNDS** to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986 [26 USCS § 401, 403, 408, 408A, 414, 457, or 501(a)].

Bankruptcy

Married, Filing Separately

A non-debtor spouse's income is only counted if it is used to pay household bills of the debtor or the debtor's dependents.

If the debtor chooses the state exemptions, then property that would be immune from state execution can be claimed as exempt.

A debtor should list the total value of marital property and indicate that it is jointly owned as tenants by entireties.

If property is not exempt, the trustee can sell/partition marital property. The trustee may sell both the estate's interest and the interest of any co-owner in property in which the debtor had, at the time of the commencement of the case, an undivided interest as a tenant by the entirety, only if--

- (1) partition in kind of such property among the estate and such co-owners is impracticable;
- (2) sale of the estate's undivided interest in such property would realize significantly less for the estate than sale of such property free of the interests of such co-owners;
- (3) the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners; and
- (4) such property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power.

11 U.S.C 363(h)

45

After a sale of property, the trustee will distribute to the debtor's spouse and to the estate, the proceeds of such sale, less the costs and expenses, not including any compensation of the trustee, of such sale, according to the interests of such spouse and of the estate. 11 U.S.C. 363(j)