



# **REDSTONE LEGAL BRIEF**

A Preventive Law Service of The Office of the Staff Judge Advocate  
Redstone Arsenal, AL

*Keeping You Informed On Personal Legal Affairs*



## **Bankruptcy**

### **THIS HANDOUT**

is provided for general information purposes; it does not constitute legal advice. If you have specific questions, call 876-9005 to make an appointment with a legal assistance attorney.

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## 1. INTRODUCTION

The purpose of this handout is to discuss, in general terms, bankruptcy issues for military members and their dependents. 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 in to 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.

## 2. WHAT IS BANKRUPTCY

a. Bankruptcy is a legal proceeding where a debtor goes to court to get debts modified or forgiven when the debtor cannot meet his or her financial obligations after the debtor has honestly made a diligent effort to pay his or her obligations. The goals of bankruptcy are (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.

## 3. 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 post Financial Counselor, at 876-5397. 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 your soldier may have bought a very expensive vehicle which causes the soldier 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 Settlements: 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 you owe. They may then 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 provide some assistance, for a "small" fee.

c. Consolidation Loan: Sometimes obtaining a loan from a financial institution will 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.

4. **TYPES OF BANKRUPTCY AVAILABLE:** Generally, four different types of bankruptcy exist. They are named by reference to the chapter in the bankruptcy code in which they are found. Chapter 7 and Chapter 13 will only be covered here since they are the ones most typically used by members:

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

b. Chapter 11: Provides relief for a business debtor by permitting the debtor to propose a plan of reorganization.

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 establishes a realistic plan where the debtor can retain much of his or her property in exchange for paying the debts back over a period of time. Thus, the debtor must have regular income for him or her to be able to complete the plan. For this type of bankruptcy to work, the creditors must approve the payment plan, which can last from 3 to 5 years.

5. **STEPS TO FILE FOR EITHER CHAPTER 7 OR CHAPTER 13:**

a. **Petition:** To initiate the process and obtain the court's protection, you must first file the petition in the appropriate federal court. Although an attorney is not legally required to file, it is extremely helpful since this is an extremely complex area of the law.

\* 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.

b. Schedules: With the petition, you are required to file schedules. These schedules must list all the debtor's creditors as well as the property owned by the debtor, the income and expenditures of the debtor, and the debtor's financial affairs. Failure to list a debt can mean you are still liable for it after your other debts are forgiven!!!!

c. Appointment of Trustee: Once the Office of the Clerk of the Bankruptcy, 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 the debtor's "non-exempt" (later discussed) property from the debtor and manage it on behalf of the creditors until the bankruptcy proceedings are terminated.

d. The 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:

- (1) Initiation or continuation of a criminal law suit
- (2) Collection of alimony, maintenance or support
- (3) 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.

e. The Creditors' Meeting: Not less than 20, nor more than 40 days following filing of the petition, the court will schedule a meeting of the 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).

f. Types of debts: Creditors generally get paid first according to the following order: (1) those that are priority claims (generally nondischargeable debts); (2) secured creditors (where a lien exists on property to ensure the loan is paid); and (3) 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.

g. 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.

## 6. ALABAMA 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) 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. Alabama opted out and established its own exemptions.

Alabama as “opted out” for the purpose of claiming exemptions in bankruptcy. Title 6, section 6-10-11. This section requires the debtor to choose only those exemptions set out under Alabama law and not those exemptions allowed by U.S.C. section 522(d).

(1) Personal exemption:

\$3,000 and in addition thereto:

- (a) all necessary and proper wearing apparel for him or her and the family
- (b) all family portraits or pictures
- (c) all books used in the family

(2) Homestead exemption: Homestead of every resident with improvements and appurtenances not exceeding \$5,000 and 160 acres.

(3) Burial place and church pew or seat

(4) rights of beneficiaries and assignees under life insurance policies

(5) Wages, salaries or other compensation of laborers or employees for personal services:

The wages, salaries, or other compensation of laborers or employees, residents of this state, for personal services, shall be exempt from levy under writs of garnishment or other process for the collection of debts contracted or judgments entered in tort in an amount equal to 75 percent of such wages, salaries, or other compensation due or to become due to such laborer or employees, and the levy as to such percentage of their wages, salaries, or other compensation shall be void. (Alabama Code. 6-10-7).

7. **Chapter 7:**

a. Purpose In this type of bankruptcy proceeding, the debtor surrenders all 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. 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.

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)

- (1) Taxes
- (2) Child support
- (3) Maintenance or Alimony (as opposed to property settlement)
- (4) Property obtained by false pretenses (includes use of credit cards)
- (5) Student loans guaranteed by a government institution unless it will impose an undue

hardship on the debtor and the debtor's dependents

(6) For willful and malicious injury by the debtor to another entity

(7) For death or personal injury caused by the debtor's operation of a motor vehicle if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance

(8) For fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny

(9) Debts scheduled by debtor in a prior bankruptcy in which the debtor waived discharge or was denied discharge for ground other than having previously filed bankruptcy within 6 years

(10) 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. Limit on filing: If the debtor has received a Chapter 7 discharge within the preceding 6 years, then the debtor is barred from filing another Chapter 7 bankruptcy. (11 U.S.C. 727(a)(8)).

d. 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 the mortgage and car payments.

### **8. 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). 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 then 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.

b. 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. 1128(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: (11 U.S.C. 1328)

- (1) Alimony
- (2) Student loan (as described in Chapter 7 above)
- (3) For death or personal injury (as described in Chapter 7 above)
- (4) Debts incurred by fraudulent representations to obtain credit
- (5) Installment debts where the last scheduled payment falls later than the date of the Chapter 13 discharge

c. 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.

## 9. 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. 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. Discharge ability of certain debts: The debtor's willingness to pay creditors will weigh heavily in consideration of approving the bankruptcy.

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: The debtor must show a desire that he wants to pay his/her creditors.

e. Co-debtors or guarantors: If members of your family cosigned a loan for you and you want to protect them, the Chapter 13 can accomplish this, since cosigners and guarantors are protected under the automatic stay. It appears this cannot be accomplished under a Chapter 7.

f. Desire to reestablish credit: You should note that debtors filing for bankruptcy may not be able to get credit from major lenders. Debtors also get a 10-year negative mark on credit agency reports and under some circumstances, 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 will probably be true if the debtor can pay close to 100% of the debt.

g. In Default on Secured Property: If the debtor is in default on secured property (such as a home or vehicle), which the debtor wants to retain, and the security interest can not be avoided,

then Chapter 13 may be the best option since it permits a debtor to cure such default on a secured debt pursuant to the plan. If the debtor wants a fresh start, though, then Chapter 7 is more appropriate and the debtor can surrender the collateral (property) if the debtor cannot cure the default.

10. **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 owing and you will have gone through much expense, time, and hardship without getting the “fresh start” you wanted.

11. **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.

12. **HOW TO START THE PROCESS OF FILING:** The debtor probably needs 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 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 800-701-0926.
- b. Attorney Referral Service: This is a state-wide service you can call and they will find an attorney in the local area who is familiar with bankruptcy law. For a 30 minute consultation,

there may be a small consultation fee. For certain low income individuals the fee can be either reduced or waived. You can contact them at 800-392-5660.

13. **WARNING!** The information provided here is general. You should consult with an expert in the field of bankruptcy to make a final determination whether to file for bankruptcy. Also, this information was obtained from a variety of sources.