BANKRUPTCY: YOUR FRIEND DURING TOUGH FINANCIAL TIMES

By **Diana Santos Johnson**

Typically, you do not think of bankruptcy as something that can empower and elevate individuals. However, as we enter 2023 with the nonstop news of record-breaking inflation and a possible recession, bankruptcy can be exactly this. During these times, it is important to remember that bankruptcy is a solution for some individuals struggling with their current finances.[1] Bankruptcy exists to give the "honest but unfortunate debtor"[2] a fresh start, but many are unaware of how bankruptcy can actually benefit individuals. This article will briefly explain how bankruptcy can assist individuals, what situations a bankruptcy filing will have the most impact on, and the qualities to look for in a bankruptcy attorney.

CHAPTERS 7 AND 13 BANKRUPTCIES

There are several types of bankruptcies – Chapters 7, 9, 11, 12, 13, 15 – but the two that primarily assist individuals and married couples – referred to as "debtors" – are Chapter 7 and Chapter 13.

Chapter 7 bankruptcies are "liquidation" bankruptcies and generally eliminate debt without a repayment plan. In this chapter, a bankruptcy trustee is appointed to sell the debtor's nonexempt assets and distribute the sale proceeds to creditors under the provisions of the Bankruptcy Code. The Bankruptcy Code does allow the debtor to keep specific "exempt" property. This is the debtor's real and personal property that is protected by state or federal law, such as equity in a home and vehicle, that the bankruptcy trustee cannot sell. If the exemption statutes do not protect property, the bankruptcy trustee will liquidate, or sell, the debtor's remaining assets. In most Chapter 7 cases, all the debtor's property will be protected, and the bankruptcy trustee cannot sell it. However, potential debtors should note that filing a petition under Chapter 7 may result in property loss. Unfortunately, a Chapter 7 bankruptcy is only available to those who pass the means test.[3] The means test is a calculation that considers several factors, including your income, expenses, and family size, to determine whether you have enough disposable income to repay your debts. If your income is below the state median, you pass the means test and can move forward with a Chapter 7 bankruptcy. If you meet the filing requirements of Chapter 7, once your case is over, your debts will be discharged, or in other words, eliminated. If the debt is secured by collateral, such as a mortgage or car, you must continue to make payments to keep these items or release them in your Chapter 7.[4]

Chapter 13 bankruptcies are "wage earners" bankruptcies because you must have regular income to repay some of your debts. This chapter allows debtors to repay some or all their debts in a three-to-five-year period. Chapter 13 debtors present a plan on how they will repay their debts. Not all debts get repaid, and the amount of your plan payment depends on various factors, including the arrears on certain obligations and the value of the collateral. Payments are made monthly to a Chapter 13 Trustee who distributes payments to your creditors. At the end of your plan, you will be current on your mortgage and could have your vehicle paid off. Any unsecured debts like credit cards, personal loans, or medical bills not paid in full during the Chapter 13 plan will get discharged. A Chapter 13 plan also allows you to keep any property that may not be "exempt" by paying the equity into the Chapter 13 plan. You also do not have to pass a means test in a Chapter 13 bankruptcy. Instead, you will need to pay any additional income into your Chapter 13 plan payment if you have disposable income.[5]

WHERE BANKRUPTCY CAN MAKE A DIFFERENCE

Bankruptcy is not the solution to all financial problems but it can improve certain situations. If you encounter individuals with the following financial dilemmas, bankruptcy may be an option that can assist them:

- **Medical debt.** A bankruptcy discharge usually eliminates medical debt. Despite the passage of the Affordable Care Act in 2010, medical debt remains one of the top reasons that individuals file bankruptcy.[6]
- **Credit cards.** A bankruptcy discharge typically eliminates credit card debt. Recent news suggests that Americans now carry more credit card debt because of higher prices due to inflation.[7]

- **Foreclosures.** If you are facing a foreclosure of your home or even a rental property, a Chapter 13 bankruptcy can help you set up a payment plan to get current. Alternatively, a Chapter 7 bankruptcy can help you walk away from the home by eliminating any deficiencies you may owe.
- **Repossessions.** If you are behind on your car payments or your car gets repossessed, bankruptcy can help you keep or retrieve your vehicle. A Chapter 13 bankruptcy will help you repay the amount you are behind on or even lower your payments, depending on how long you have owned the vehicle. If you no longer want to keep your car, a Chapter 7 can help eliminate any balance you may have owed on the car after it was sold at auction.
- **Temporary setbacks after a job loss.** Many Americans live paycheck to paycheck, and a job loss will wreak havoc on personal finances. A Chapter 13 bankruptcy would allow debtors to repay mortgage payments, car payments, and other debts that may have gotten behind due to a job loss.
- **Civil lawsuits.** Both Chapter 7 and Chapter 13 bankruptcy stop civil actions from moving forward through the automatic stay. The automatic stay is an injunction that stops lawsuits, foreclosures, garnishments, and all collection activity against the debtor when a bankruptcy petition is filed.[8]
- **Wage Garnishments.** Some states allow for wage garnishments based on civil judgments. A Chapter 7 or a Chapter 13 bankruptcy will stop the wage garnishment and allow you to keep your hard-earned income.

While this list is not exclusive, these are typical situations where bankruptcy can be your friend. It is important to note that while bankruptcies have eliminated student loans in some instances, a bankruptcy filing will not typically discharge student loans.[9]

FINDING THE RIGHT BANKRUPTCY ATTORNEY

Bankruptcy is a specialized area of law (there are separate bankruptcy courthouses!), and it is vital to find a knowledgeable attorney if you are considering filing bankruptcy. One of the keys to being comfortable filing bankruptcy is finding an attorney who thoroughly explains the eligibility requirements and the entire bankruptcy process to you. Look for attorneys who personally handle the consultations, especially the initial consultation.

You also want to ensure that your attorney answers all your questions about the bankruptcy process. For many, speaking with a bankruptcy attorney is the first time individuals honestly assess their entire financial picture. You want to know that the attorney is answering your questions and giving you the information you need to decide if bankruptcy is the right step for you. Many individuals are concerned about how their credit will be impacted by filing bankruptcy. An effective bankruptcy counsel will not only take this concern seriously and address the potential consequences of filing bankruptcy but can also explain what happens to your debts and your credit if you do not file bankruptcy.

Bankruptcy attorneys typically advertise their services on television or the radio. Still, another way to find a bankruptcy attorney is to talk to family members and friends who have filed bankruptcy. Ask them if they were satisfied with their bankruptcy attorney and experience. Often, the best bankruptcy attorneys do not advertise and find new clients solely through word of mouth.

Bankruptcy exists to give individuals a fresh start. With the proper knowledge and understanding of how bankruptcy works, bankruptcy can become your friend and empower individuals to overcome their financial problems in 2023.

Diana Santos Johnson *is a business bankruptcy attorney at Waldrep Wall Babcock & Bailey PLLC in Winston-Salem, North Carolina. Before joining this firm, Diana spent over a decade assisting individuals and small business owners file bankruptcy and receive a fresh start.*

[1] Filing bankruptcy is a decision that is made on a case-by-case basis, and this article is not intended for legal advice. If you are considering bankruptcy, please meet with a qualified bankruptcy attorney who can assist you in making this determination.

[2] 7 Collier on Bankruptcy ¶ 1112.07[3] (citation omitted).

[3] *See* 11 U.S.C. § 707(b)(1)-(2).

[4] This is an overview of a Chapter 7 bankruptcy. The complete statutory requirements of Chapter 7 bankruptcies can be found at 11 U.S.C. §§ 701-784.

[5] This is an overview of a Chapter 13 bankruptcy. The complete statutory requirements of Chapter 13 bankruptcies can be found at 11 U.S.C. §§ 1301-1330.

[6] Kimberly Amadeo, "Medical Bankruptcy and the Economy," The Balance (January 20, 2022), available at https://www.thebalancemoney.com/medical-bankruptcy-statistics-4154729.

[7] "Americans are piling up credit card debt — and it could prove very costly," NPR (January 11, 2023), available at https://www.npr.org/2023/01/11/1148122555/credit-card-debt-inflation-interest-rate-payments-federal-reserve.

[8] *See* 11 U.S.C. § 362.

[9] See NCLC Publication, New Process to Discharge Student Loans in Bankruptcy, which describes Guidance issued by the Department of Justice on how bankruptcy debtors can obtain discharges of their student loans using a ten-step process. John Rao, New Process to Discharge Student Loans in Bankruptcy, NCLC (December 12, 2022), available at https://library.nclc.org/article/new-process-discharge-student-loans-bankruptcy.