

# Chapter 7's potential headaches can be avoided

By Jeff Mathias\*

*Whether due to illness, job loss, dissolution, imprudent credit allocation or poor financial planning, this year we again see more consumers seeking bankruptcy protection.*

*Last year, 11,742 bankruptcy cases were filed in Iowa; 95 percent of those were under Chapter 7. So far, 2003 appears to be headed for another record, up about seven percent over 2002. More than ever, Iowa consumers need competent legal representation as they consider bankruptcy. In this article I will provide a basic overview of Chapter 7 consumer bankruptcy practice from the view of debtors counsel and also discuss some current practice issues.*

## Case Evaluation

Careful case evaluation can reduce headaches as the case progresses. Recent large credit card use may not be discharged because of what is called "loading up," a presumption that luxury purchases/cash advances were made within 60 days of filing. Debt acquired through this fraud or falsification of financial statements may not be discharged. A recent home purchase with significant equity where debt predated purchase date may require settlement with bankruptcy estate. If the client has made recent preference payments to family the estate may recover payment. If the client has an unperfected lien on secured property the lien could accrue to the estate.

Also, significant disposable income after

expenses may garner a substantial abuse complaint. Small business accounts receivable and inventory are not exempt. "Toys" like a camper or boat and the like are not exempt, pending lawsuits/claims against others are not exempt, large tax refunds have only limited exemption, and recent large claimed gambling losses may need proof of loss to defeat an inference that the debtor may be hiding funds.

Some of the trustees are also looking more carefully at accrued wages, so it is best for debtors to file as soon after a payday as possible. Cars are generally not a problem due to high security interest or low value. If your client has an extra "junkie," be sure to detail some of its faults in the petition. This should be true for all property that may be at risk. Debtors should be encouraged not to overvalue personal property and collectables.

In general, the estate does not want to actually take possession of non-liquid non-exempt assets. The trustees need to recover reasonable value, but will try to work with the debtor on a fair repurchase. The most common generally non-dischargeable debt – taxes, student loans and child support – should be discussed with clients.

A surprising number of clients will have significant liquid assets, so a careful examination concerning bank balances, stocks and such may root out assets the client is hesitant to reveal even to counsel. Clients should be warned that the exemption for cash on hand is limited to \$100 per person.

New clients will often come in based

on a triggering event such as a wage garnishment or foreclosure in progress. Under such stress, they may not hear your admonitions about non-exempt tax refunds or other issues. Later, when the issue arises the client will claim you failed to give warning. Hence, a letter to the client summarizing these issues, which you sent prior to filing, may protect you later.

Finally, case evaluation is the best time to give the client a "reality check." If clients are intending to keep their home or business that would be economically disastrous, efforts should be made to dissuade them. Frequently, you will be unable to do so during the first interview. Sometimes a detailed letter explaining the risk of economic failure after discharge can persuade the client to do the right thing.

## Preparation and Filing of the Petition

Most attorneys have the client fill out a packet of financial information from which the petition is drafted. Some of the commercial bankruptcy software now has the ability to import creditor addresses from credit reports online. In any case, clients must be informed that not all creditors report and it is the client's responsibility to ensure that all debts are scheduled. Scheduling the original creditor, collection agency, collecting attorney and in case of suit the clerk of court and sheriff will reduce headaches later.

Of course, lack of full disclosure and inadvertent errors/inaccuracy on petitions can result in big problems for the debtor down the road. Hence, most attorneys will provide multiple opportunities for the client to review and confirm the contents of the petition. Now that the Southern District is up and running on electronic filing, high speed Internet access and Adobe Acrobat software are needed for filing there, although electronic filing is still optional in the Northern District. I have found Best Case bankruptcy software to be very helpful with electronic filing.

## The Automatic Stay

The most conspicuous feature of consumer bankruptcy is the automatic stay. The automatic stay is designed to protect

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the debtor and the debtor's property. The stay also prevents individual creditors from "picking away" at debtor assets to the detriment of other creditors.

The stay is effective against all entities and brings almost all forms of civil legal action against the debtor to an abrupt halt, 11 USC 362(a)(1)-(8), Willford v. Armstrong World Industries, Inc., 715 F.2d 124, 126 (4th Cir. 1983). Actions taken in violation of the stay are void as a matter of law, see In Re Schwartz, 954 F.2d 569, 26 C.B.C.2d 649 (9th Cir. 1992) (IRS violation of stay was void, not voidable).

Hence, wage and bank garnishments, foreclosure and repossession must halt upon filing of the petition. Acceptance of payroll deductions after filing violates the automatic stay, Matter of Hellums, 772 F.2d 379 (7th Cir. 1985). Attorney fees and costs are mandatory for willful violation of the automatic stay and punitive damages are also available, United States v. Ketelson 880 F.2d 990, 993 (8th Cir. 1989).

A couple of other common automatic stay issues – normally, a driver's license revocation based on an unpaid accident judgment cannot be continued after discharge, Perez v. Campbell, 402 U.S. 637, 91 S. Ct. 1704 (1971). Withholding of a student's transcript for non-payment of a discharged debt is prohibited, In re Merchant, 958 F.2d 738 (6th Cir. 1992).

### Reaffirmations/Redemption

Since all of the debtor's contractual obligations are stayed, a reaffirmation is used to renew the debtor's obligation. In some cases, the bank will negotiate a reduced interest rate or balance on reaffirmations, but others never negotiate. The costs of recovery, storage and disposal of secured property will often keep retailers from repossessing secured property, so at most your client may want to make a modest offer to keep secured furniture or appliances.

If you believe a client should not reaffirm a debt, but they insist anyway, you may want to advise them to just continue payments without reaffirming. Many courts have held that attempts to take possession of property after bankruptcy are prohibited as long as the debtor is current on payments, In re Parker, 139 F.3d 668 (9th Cir. 1998).

Clients should almost never reaffirm unsecured debt. Credit card companies will often close all accounts of bankrupt

cardholders anyway so it may be pointless for the client to try keeping a card. Instead, they should use a bank debit card for reservations and Internet purchases. Clients should discharge debt with a co-debtor after which they can make voluntary payments if they wish. If the co-debtor files bankruptcy or is otherwise judgment proof, the client will not be bound.

Most clients cannot come up with the money, but if they can they may redeem secured property by paying current market value to the creditor in exchange for a release of lien; no court filing is required unless fair market value cannot be agreed upon and a hearing is required.

### Meeting of Creditors

The "341 Meeting" is usually the only significant event after filing. Here, the panel trustee has the opportunity to examine the debtor and verify the contents of the petition. Rarely, creditors will appear to inquire as to availability of assets. The debtor must bring a photo ID and proof of social security number and should review the petition prior to the hearing.

### Adversary Proceedings and Post Hearing Issues

Common adversary proceedings include false pretenses – including "loading up" – and fraud claims. If the debtor charged in excess of \$1,150 in consumer debt with one creditor within 60 days of filing there is a rebuttable presumption of false pretenses, 11 U.S.C. 523(a)(2)(C). Often, banks seem to file these adversaries without the presumption and with little or no proof the debtor did not intend to repay. In some cases, a letter to counsel discussing a debtor's burden of proof, perhaps with some favorable facts about your client and affirming your intent to

seek attorney fees from the creditor, will result in a voluntary dismissal. With respect to fraud claims, the exceptions to discharge are narrow and a few favorable facts such as the creditor having increased the credit limit or the debtor continuing to make minimum monthly payments can be very favorable to debtors.

Common post hearing issues include resolution of pre-acquisition debt on the home (negotiated settlement with trustee), un-perfected lien issues (in which case the client may be able to purchase the asset from the estate for less than the now avoided lien), large recent credit card use (often was not disclosed to counsel, can usually be settled with the bank), liquid non-exempt property (trustee will want all non-exempt amounts of liquid property such as tax refunds exceeding exemption) and non-liquid assets such as campers (usually can be purchased from estate for less than market value).

### Further Information

Colliers Consumer Bankruptcy is an excellent one volume practice guide. The Northern ([www.ianb.uscourts.gov](http://www.ianb.uscourts.gov)) and Southern District websites ([www.iasb.uscourts.gov](http://www.iasb.uscourts.gov)) have a lot of information including opinions.

Eighth Circuit cases are available at [www.ca8.uscourts.gov/opinions](http://www.ca8.uscourts.gov/opinions) The Federal Rules of Bankruptcy Procedure are available at [www.law.cornell.edu](http://www.law.cornell.edu) Google.com is surprisingly effective at finding forms in downloadable ".pdf" format.



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