

Preface

Welcome to *Understanding Bankruptcy*, an informational study guide we are providing as a service to you. By using this study guide, you'll find the answers to such basic questions as:

- What is bankruptcy?
- How is it designed to help people in difficult financial situations?
- What can I do about my debts?
- Will I have to give up my property and assets?
- What is the difference between Chapter 7 and Chapter 13 bankruptcies?
- What legal procedures are involved?
- How can my attorney help me?

This study guide also contains a glossary of legal terms you may need to know.

NOTE: This program is **not** designed to give you legal advice: only an attorney can do that. But by teaching you the basics of bankruptcy, the program can help you use your attorney's time more efficiently, and identify some of the key questions you'll need to ask.

We hope you find this program useful.

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Introduction

Bankruptcy: an Important Decision

Whether or not to file for bankruptcy is an important decision. Bankruptcy can offer you a fresh start if you find yourself overwhelmed by debt. This can happen for legitimate, and sometimes unforeseeable, reasons. For example, people can become financially overextended because of losing a job or having a medical problem.

But bankruptcy has many possible consequences for your property and assets, for your future ability to get credit, and for the people to whom you owe money. You should discuss all your options with your lawyer before deciding on a course of action.

The Bankruptcy Laws

In the United States, the main laws covering bankruptcy are federal laws, so they apply in all 50 states. A special federal bankruptcy court system has been set up to administer these laws.

However, each state has its own bankruptcy laws, too. In some cases, there are even local bankruptcy rules. And judges may have some differences from district to district. The result is that bankruptcy can be a complex legal matter.

All together, the law provides five different forms of bankruptcy. Most likely, though, only two of these will apply to your situation: Chapter 7 and Chapter 13. "Chapter" refers to where in the Federal Bankruptcy Code the law can be found.

Before considering the differences between Chapter 7 and Chapter 13, let's look at what they have in common.

The Basics of Bankruptcy

Procedures

Like most legal matters, bankruptcy involves a variety of forms, procedures, requirements and paperwork. This is all standard and must be followed.

It assures that the laws are obeyed, and that the rights of your creditors - that is, all the people you owe money to - are protected.

You need to know that failure to follow the rules or to give complete and honest information throughout the process may cause your case to be dismissed. This could endanger your right to file bankruptcy, could cause delays, and could end up costing you more money.

Discharge of debts

Getting relief from the burden of your debts by having them canceled is one of the most important benefits of bankruptcy. When a debt is canceled so you don't owe it anymore, this is called a discharge. Will ALL of your debts be discharged? This depends on several factors.

There are certain debts that are generally NOT discharged. These include taxes, school loans, child support, maintenance, and traffic fines. But there are some rare exceptions in these cases. Also, there are certain debts that are dischargeable in Chapter 13 but not in Chapter 7.

The discharge of debts is a complex issue, so you need to be careful here. Your attorney will be able to advise you about your own particular situation.

Secured vs. Unsecured Debts

Your debts fall into two major categories, which are treated differently in bankruptcy.

One type of debt is called **secured debt**. It's called "secured" because it's backed up by some property. If you took out a loan from a bank or other financial institution to buy a house, motorcycle, trailer, boat, truck or car, etc., it's probably a secured debt. Before the lender gave you the loan, you had to sign documents that gave the lender a "security interest" in your property - that is, you gave the lender some rights to the house, motorcycle, etc. that you were buying with the loan. These documents guarantee that you'll repay the full loan amount plus interest. They also prohibit you from selling the property without repaying the debt. In general, after bankruptcy the lender's security interest (lien/mortgage) in your property still remains.

The second type of debt is called **unsecured debt**. Such debts are usually for consumer goods and services, such as what you owe to local stores, credit cards, medical bills and utilities. These debts are often discharged in bankruptcy.

Property Exemptions

In bankruptcy the laws allow you to keep certain property in order to preserve your ability to live. This is called **property** exemptions. Exempt property may include your home, car, personal belongings, furniture and television.

State and federal laws sometimes allow different property exemptions. You must, with the advise of your attorney, choose between these different federal and state exemptions. Depending on your particular situation, choosing one set of exemptions over the other may make a great difference in the property you're allowed to keep.

In any case, there are rules to follow regarding exemptions. For example, if you have a mortgage on your home, or if you used any of your personal property, such as a car, to secure a loan, you must continue to make payments. If you don't, the lender can foreclose or repossess your property.

There are also some dollar or value limits to exemptions.

Automatic Stay

Another important protection you receive immediately when you file for bankruptcy is an order granted by the bankruptcy court preventing any of your creditors from taking any action against you, the debtor.

This is called an **automatic** stay. It prohibits any judgments, lawsuits, small claims actions, garnishment of your wages, repossessing of your property, or shutting off your utilities. This gives you a little breathing room to sort out your affairs without being harassed by your creditors. It even puts a stop to those nagging letters and phone calls you may be getting.

Reaffirmation

You may decide to make a pledge to repay one or more debts. This is called **reaffirming** the debt.

Chapter 7 Bankruptcy

A Chapter 7 bankruptcy is also commonly known as a **straight or liquidation** bankruptcy. Its goal is to relieve you of indebtedness.

Trustee

An individual known as a **trustee** is appointed to oversee your bankruptcy. The trustee is usually either a local attorney or a federal employee.

The trustee in a Chapter 7 bankruptcy must make sure all the procedures are being followed according to the law. He or she also reviews the information in all the documents you filed with the court.

Will Property Be Liquidated?

In a sense, the trustee takes possession of any of your non-exempt property or assets, and may liquidate it to raise money. This money is then used to pay certain creditors who are eligible under the law.

Does that mean you'll lose everything in this process? Not at all. In most cases you'll lose little, if any of your property or assets. That's because most of your property is either secured or exempt, so little, or sometimes nothing, may be left to pay your creditors.

Your Section 341 Hearing

During a Chapter 7 bankruptcy, you're required to attend at least one court hearing. This is known as a Section 341 hearing, or the first meeting of creditors.

This meeting generally takes place about 30-40 days after your initial paperwork is filed with the court. Besides you and your attorney, the trustee will attend the Section 341 hearing, as will any of your creditors who want to be there. The trustee and your creditors are entitled to ask you questions about your property and assets, the debts you owe, and even about how you've handled some of your recent financial matters. They can do this to try to uncover

any illegal transfers you made to have your assets or recent purchases not allowed before bankruptcy.

Don't miss this meeting! Doing so could have some negative consequences for you. These include additional expenses, unwanted delays, or having your case dismissed. This would remove the automatic stay and any protection you might need from your creditors. So be sure you attend this meeting.

Besides the Section 341 hearing with your creditors you may be required, in some cases, to appear in court again. Sometimes this happens if your creditors object to your property exemptions or the debts you're asking to have discharged. If they do, the bankruptcy court will decide which side will win.

How Long Does It Take?

The entire Chapter 7 bankruptcy procedure generally takes about three months. In the end, it results in the cancellation of many of the debts you owe. Free from harassment by your creditors, you get a fresh start.

You can only file a Chapter 7 bankruptcy once every eight years.

Chapter 13 Bankruptcy

A Chapter 13 bankruptcy is also known as a **wage earner's or repayment** bankruptcy. Just as its name implies, it provides a way to repay all - or at least some - of the money you owe to your creditors from the income or wages you earn. Some think of it as sort of a debt consolidation.

Developing a Repayment Plan

In a Chapter 13, you develop a **repayment plan** with the help of your attorney, and submit it to the court within 15 days after you file for bankruptcy. Your plan lets you pay back the money you owe at a rate that you can afford. This repayment plan usually takes three to five years.

You prepare a budget showing all your necessary living expenses, including your house payments. These types of expenses are paid before any payments are made to the plan for your creditors.

How Much of Your Debt Do You Pay?

It's common in a repayment plan to pay less than the full amount you owe, and still receive a discharge of the full amount at the end of the plan. But that's only if you've met all of the requirements of your plan.

The money that you pay to your plan goes to a court appointed bankruptcy trustee, who distributes the money to your creditors according to the terms of the plan.

Property Exemptions

Similar to a Chapter 7 bankruptcy, in a Chapter 13 you're allowed to claim or declare **exemptions**. That is, certain property of yours is exempt from your creditors, although the effect of the exemptions on your property may be different in a Chapter 13 than in a Chapter 7. Your attorney can advise you based on your specific situation.

Your Section 341 Hearing

Also like a Chapter 7, you'll have to prepare a lot of the necessary paperwork and attend a Section 341 hearing. At this meeting, the bankruptcy trustee will review your proposed plan. You may be asked questions so the trustee can determine if your plan is really your best good faith effort. That is, are you paying your creditors as much as you can afford?

If the trustee believes that your plan meets all the necessary requirements, he or she will recommend that the bankruptcy court accept or confirm your plan.

Automatic Stay

Again, as in a Chapter 7, a Chapter 13 gives you an automatic stay that stops any of your creditors from suing you, garnishing your wages and harassing you in any manner. In both Chapters 7 and 13, the automatic stay is not unlimited.

You can file a Chapter 13 more often than once every six years.

Chapter 7 or Chapter 13?

How do you decide whether a Chapter 7 or a Chapter 13 is best for you? The answer to this can only come through the consultation and advice of someone like an attorney, who has studied and understands the bankruptcy laws, knows the rules, and also fully understands your situation.

Provide All Necessary Information

Before your attorney can give you advice, you'll have to provide complete information, such as employment information - including the wages you and your spouse earn; a list of all creditors with their addresses, the amount you owe, your schedule of payments and any collateral or papers you signed for the debt. **(You also need to list money you owe and intend to pay back, even if it's to a relative.)** Also, a list and description of all your property and assets, including boats, automobiles, furniture, jewelry, checking and savings accounts; a legal description of all real estate; a list of your monthly expenses including mortgage or rent, food, transportation, utilities, child support, real estate tax, and other regular expenses; and copies of your income tax returns for the last two years.

Be forthright and open with your attorney. Complete information is essential, so don't hold back information because you think it may not be important. Let your attorney decide if the information is important. Otherwise he or she won't be able to do an effective job of representing your interest. Only by reviewing all the information you provide will your attorney be able to fully understand your particular situation and your determination or ability to repay debts. Only then can he or she advise whether you should declare bankruptcy, and if so, which kind to file.

Paperwork

If the decision is made to file for bankruptcy, the bankruptcy court requires a lot of necessary forms and paperwork to be filled out and submitted, these include a **petition** that requests that the court accept your case, a **statement of affairs** that answers pertinent questions about you, a list of all your **assets, debts, income and expenses**, plus certain other forms required by the local rules of your bankruptcy court. Your attorney prepares these from the information you provided.

Does Your Spouse File?

If you're married, you and your spouse may be filing a joint petition, or in some cases your spouse may not file. Again, your attorney can help advise you whether you should file together or separately.

Additional Information

Can You Ever Borrow Again?

Naturally, many people wonder if they'll ever be able to get credit again after filing for bankruptcy. That depends on a lot of factors. The bankruptcy may be on your credit record for up to 10 years. Many lenders still appear to be willing to grant credit, although they may look at why you went bankrupt to make sure you've corrected the situation that led to your bankruptcy. Getting credit cards depends on the company's policy.

It might be difficult or expensive to be issued credit cards.

Co-signers

Co-signers of any of your debts are treated differently in Chapter 7s and Us. To some, this is a very important issue. Generally, in a Chapter 7 liquidation bankruptcy creditors can pursue co-signers of your loans if you default, but in a Chapter 13, your co-signers have more protection if you follow your plan.

How Much Will This Cost?

In bankruptcy proceedings you're responsible for paying the court costs and filing fees which varies between \$435 and \$470 depending on whether the case is filed under Chapter 7 or Chapter 13, and also depends on whether the case is for a single person or a married couple. These are current amounts but can change in the future.

And, of course, you're responsible for paying the fees of your attorney. How fees are handled varies from area to area and from office to office. Many attorneys require the full fee up front, but some will accept a down payment and payments in the future. In some jurisdictions, the fees for Chapter 13 are set by the court and paid through your repayment plan. You have the right to discuss fees with your attorney and to reach a clear understanding of how much it will cost.

Glossary

Acceleration Clause - A provision in a credit agreement which allows a creditor the opportunity to immediately demand repayment of an entire amount of debt owed because of a debtor's default.

Answer - A written statement by a defendant in a lawsuit stating the reasons for his or her defenses to the statements made by the plaintiff.

Attachment - Process of seizing a debtor's property in order to secure the debt or claim of a creditor in the event that a judgment is taken against a debtor.

Bankruptcy - A condition where a debtor cannot pay debts now or as they come due and uses the protection of the law to either liquidate property or reorganize his or her financial affairs.

Bankruptcy Code - Federal law which governs bankruptcy proceedings.

Bankruptcy court - Special courts under federal law which deal exclusively with administering bankruptcy proceedings, presided over by a bankruptcy judge.

Bankruptcy estate - The property of a debtor which comes under the jurisdiction of the bankruptcy court and trustee when a person files for protection under the Bankruptcy Code.

Bankruptcy trustee - A person appointed by the bankruptcy court to take charge of the bankruptcy estate and handle any actions on behalf of the estate.

Chattel - Movable property; see also personal property.

Circuit court - The courts named by county, where most civil actions are begun.

Civil action - Lawsuit dealing with controversies between individual parties, in contrast to a criminal action.

Collateral - Property which a debtor agrees to pledge as security for the repayment of a debt.

Creditor - One who is owed money or some other thing by obligation or promise.

Debtor - One who owes a debt.

Default - A failure to perform an obligation imposed by law or contract.

Deficiency - The unpaid balance of a debt on which there is a security agreement, where the sale of the secured property has failed to pay the full amount of the debt owed.

Deficiency judgment - Court order for personal liability of the debtor on a deficiency.

Discharge - The cancellation of an obligation.

Equity - The value of property belonging to an owner above the amount of all mortgages.

Eviction - The action of depriving a person of the possession of land or rental property which the person has held or leased.

Execution - The legal process of enforcing a judgment. A money judgment is usually executed by seizing and selling property of the debtor.

Exemption - A privilege allowed by law to a judgment debtor that he or she may hold certain property from all liability to being seized or sold on execution or by any other court order.

Foreclosure - A process by which a creditor with a mortgage can force a debtor to give up his or her interest in the property because of default. The creditor can then have the property sold to satisfy the debt. Also may be referred to as foreclosure by sale, or performance foreclosure. See also strict foreclosure.

Garnishment - A process under law where a debtor's property, money or credits under another party's control are applied as payment of a debt to a creditor.

Homestead - A dwelling house or mobile home and the adjoining land where the debtor resides and is protected from the claims of creditors and is free from being seized or sold for the payment of a person's debts.

Interest - A right or legal share in something.

Judgment - a determination of law as the result of an action in court as to whether a legal duty or liability does or does not exist.

Judgment creditor - A person who has obtained a money judgment in court and can now enforce the judgment by execution.

Judgment debtor - A person who has a money judgment taken against him or her which has not been satisfied.

Judgment lien - A lien which can be filed by a judgment creditor against real property of a judgment debtor in order to satisfy the judgment.

Land Contract - Installment agreement for the purchase and sale of land.

Lien - An interest in collateral which provides that the collateral may be taken and sold in order to pay a debt if a debtor defaults. See also security interest.

Mortgage - A lien on real property.

Personal property - Movable property. See also chattel.

Purchase money security interest - A lien which is created when a debtor uses money loaned by a creditor to make a purchase and gives the creditor a lien on the property purchased with the creditor's money.

Real property - Land, real estate.

Redemption - The right of a debtor to regain title to property under a foreclosure judgment by paying the judgment of fulfilling other conditions.

Replevin - An action to recover personal property by a party with a lien or security interest on the property.

Secured debt - A debt subject to a security interest.

Secured party - A creditor, seller or other person who holds a security interest in the property of a debtor.

Security agreement - A written document which creates or provides for a security interest.

Security interest - An interest in collateral which provides that the collateral may be taken and sold in order to satisfy a debt if a debtor defaults. See also lien.

Small claims court - A court which provides quicker, more informal and inexpensive judgments in actions for evictions or replevin of property.

Strict foreclosure - The process by which a creditor receives title to real property without a period for redemption or sale of the property in exchange for having no right to obtain a deficiency judgment.

Summons and complaint - Documents used to begin a civil action.

Unsecured debt - Debt not subject to a security interest.

Unsecured party - A creditor, seller or other person who is owed a debt without having obtained a security interest through a security agreement on property of the debtor.