

# CONSUMER BANKRUPTCY

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Milligan, Russell A. Perry, Joshua P. Searcy,  
Sonja D. Sims, and M. Jermaine Watson.

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# CONSUMER BANKRUPTCY

*I cannot pay my mortgage or my car payment...help!*

There are times in every person's life when money is tight. Sometimes you can be so short on funds that you get behind on your car payment, house payment, or even taxes. If you are in this situation, a good place to start is by contacting your lenders. Many lenders have programs designed to help you make your payments. If your lender has no such program, or if you cannot meet the requirements of the program, then bankruptcy may be an option worth exploring. Bankruptcy can help with your bills and force your creditors to work with you within the confines of the law. To understand how bankruptcy can help you, you need to understand a few basics about debtor-creditor relationships.

Generally there are two types of debt you may owe; either a *secured* debt or an *unsecured* debt. The nature of your debt is important because secured and unsecured debts are treated differently in bankruptcy, and creditors have different rights against you depending on the type of debt. A *secured* debt is one where the creditor has collateral to repossess or foreclose against if you fail to make your payments. Car loans, home mortgages, or appliance financing agreements are all examples of *secured* debts. Compare this to an *unsecured* debt. An *unsecured* debt is one where there is no collateral, such as a credit card or signature loan.

If you fail to pay an unsecured debt, then your creditor has to sue to try to collect this debt from you. However, if you do not pay your mortgage payment, then the bank will foreclose your home. Here is how foreclosure works. After you get behind on your mortgage payments, your lender is required by law to send a letter, usually by registered certified mail. This letter is called a *Notice of Default and Intent to Accelerate*. It will generally state that you are behind on your mortgage payments, you have 30 days to bring the payments current, and if you fail to bring your payments current that the bank will accelerate the full balance of your loan and post your home for foreclosure. *Acceleration* of a loan means that the full amount you owe will then be due, rather than any regular payments you have missed.

If you fail to bring your payments current on or before deadline in the first letter, then you will receive a second letter called a *Notice of Intent to Foreclose*. This letter will also come by registered certified mail. It will generally state that your lender sent you the first letter, you did not pay by the deadline, your loan has been accelerated, and unless you pay it in full, the bank will foreclose on a specific date. This second letter must state the date and time of the foreclosure sale. Foreclosure sales can only be held on the first Tuesday of the month on the steps of the courthouse in which your home is located. Only two notification letters are required to foreclose on your home.

Repossessing a car is an even easier process for creditors. Creditors are not required to give

any notice prior to repossessing a car. They simply have to take possession of the vehicle without causing a *breach of the peace* - that is, without any violence. For example, a lender cannot repossess your car by towing it away with you inside. After they take possession of your car, the lender can sell it as long as they give you ten days' notice prior to the sale, and as long as the sale is performed in a commercially reasonable manner. Thus, you can see that foreclosure and repossession are not difficult rights to exercise. That is why *if you are behind on your house payments, you need to go and see an attorney at once.*

Despite the processes described above, you as the debtor are not without rights. There is a law called the Fair Debt Collections Act that protects you from harassment by your creditors. Creditors are generally not supposed to call you all hours of the day and night or harass you at work or at home. If they call, you can tell them to stop calling you and they are supposed to stop. If they fail to stop, then you can attempt to sue them to make them stop.

### ***What happens if I cannot pay my bills?***

If you've lost your job or suffer from some other circumstance that causes a reduction in income, you may not be able to pay your bills each month. This could cause credit cards or mortgages to go into default, as discussed above, and could negatively affect your credit. If you fail to pay bills as they become due, the creditor may be able to report the default in payments to the three credit bureaus, Experian, Equifax, and Transunion, which

could negatively affect your credit score, or “FICO” score.

Why should you care what is included on your credit report? Many parties may view your credit report and credit score, including insurance providers and potential employers, as well as lenders and credit card companies. The lower the credit score, the more of a credit risk you pose to a potential lender. The higher the score, the better, so it is important to try to pay bills on time, avoid defaults, and work to keep a clean credit report. Additionally, negative entries on your credit report can remain on the report between seven and ten years, so, if possible, it is important to try to avoid negative entries on your credit report.

To view your credit history and obtain your credit score, you can contact the three credit bureaus, Experian, Equifax and Transunion. You are allowed to check your credit report once per year without charge by visiting [www.annualcreditreport.com](http://www.annualcreditreport.com), which allows you to print your credit report from all three credit bureaus at once. You may also request a copy of your credit report from the three credit bureaus for a fee, and generally will be charged a separate fee to view your FICO score. Be wary, however, of companies that advertise free credit reports, as many companies only provide the reports after you enroll in a credit monitoring program with a monthly fee.

Once you have reviewed your credit report and credit score, there may be various ways to increase your credit score moving forward. One way to maintain a good credit history is

to pay all bills as they come due. Also, if after reviewing your credit report, you note that there is a mistake on the report, such as an entry you don't recognize, or an account that is not in default, you have the right and the ability to challenge that entry with the respective credit bureau to ensure that the entry on your credit score is correct. You can also attempt to cure defaults with creditors included on the report, if appropriate.

If you are unable to pay your bills as they come due, you may have additional options. One option may be to work out a payment plan with your lenders. Credit card companies may be willing to reduce the interest rate charged on credit cards, or may take a reduced amount in settlement of the charges if the reduced amount can be paid immediately. Other creditors may agree to accept partial payments on accounts over time or may agree to alternative payment arrangements, depending on your agreement with them. Additionally, many mortgage companies may consider renegotiating or modifying your mortgage if you are unable to make monthly mortgage payments. You may wish to contact your creditors to see what options they will extend if you have encountered financial difficulties.

You may also have the option of obtaining credit counseling from organizations who can instruct you on how to negotiate settlements of your debt over time. However, it should be noted that there are many unscrupulous companies who describe themselves as providing "credit counseling services". It is worth checking with the local business bureaus or looking for

reviews from previous participants to ensure that you are receiving information and counseling from a reliable source.

Yet another option is to file for bankruptcy protection. By filing bankruptcy, you are filing a federal court action that can shield you from collection efforts while you are allowed the opportunity to either liquidate non-exempt property to pay your creditors, or allow you to take steps to reorganize and propose a repayment plan to pay creditors over time. As bankruptcy can significantly affect your credit score for a period of up to 10 years, it should be viewed as a last resort.

### ***What IS bankruptcy?***

Bankruptcy is a process under the law which allows individuals, families, some companies, and even cities, to discharge (wipe away) or to reorganize (modify repayment terms) the debts they owe to their creditors. To the uninitiated it can be a confusing and sometimes intimidating process. It is important to speak to an attorney familiar with bankruptcy law before considering filing a bankruptcy petition.

There are five types, or chapters, of bankruptcy. These are Chapter 7, 9, 11, 12, and 13. Consumers (people like you and me) typically file either Chapters 7 or 13. In either case a Trustee is appointed by the Court to look out for the benefit of your creditors. In Chapter 7, the trustee mainly gathers and sells your non-exempt assets. In Chapter 13, the trustee mainly collects payments you make to him under a plan approved by the Court, and then



uses that money to pay off part of your debts. There is an “automatic stay” which protects you during bankruptcy from any attempts by creditors to collect on debts you owed at the time your bankruptcy case was filed. However, creditors in both chapters can file proofs of claim to try to get paid some of the money they are owed by the Trustee, and can take other actions with Court permission to protect their interests and try to get paid. Thus, the main players in bankruptcy (other than the Judge, of course) are the debtor who files bankruptcy, the creditors who are owed money, and the Trustee who oversees the cases which are filed.

Bankruptcy is designed to give you a fresh start, to allow you as the debtor to escape from debts which are no longer manageable so that you can again become a productive member of society. In many other countries, people who cannot pay their debts are simply thrown in jail. In this country, we have the bankruptcy system. There are some restrictions on filing bankruptcy. For example, certain types of debts cannot be discharged. These include back child support, many types of federal taxes, and debts owed as a result of fraud or wrongdoing. Another restriction is that a person typically cannot file bankruptcy more than once every 8 years.

There are also some things which bankruptcy cannot do for you. Bankruptcy cannot increase the amount of money you earn each month. If you do not earn enough money each month to pay your basic living expenses, bankruptcy cannot change this. It can help you reduce some expenses in order to make

ends meet, but it will not increase the size of your check each month. Bankruptcy also will not let you keep property for which you have not already paid. For example, if you have a mortgage on your home you will either have to keep making the payments to your mortgage lender or give up your house. You cannot keep it and not pay for it. Otherwise, there are many helpful things you can do in bankruptcy.

***What property do I get to keep if I file for bankruptcy?***

You may be wondering whether you have to give up all of your property in order to file bankruptcy under Chapter 7 or 13. The answer to that question is no! All of your property considered “exempt” under the law is yours to keep. There are two different sets of property considered “exempt” – the federal set and the state set. Depending on your situation, one or the other will be most advantageous. Again, the best thing to do in making this determination is to speak to a bankruptcy attorney. The Texas exemptions allow you keep your homestead, no matter the value, and up to \$60,000.00 of property in the following categories (\$30,000.00 for an individual):

- 1) home furnishing, including family heirlooms;
- 2) food;
- 3) farming or ranching vehicles and implements;
- 4) tools, equipment, books, and apparatus, including boats and motor vehicles used in a trade or profession;
- 5) wearing apparel;

- 6) jewelry not to exceed \$15,000.00 (married couple) or \$7,500.00 (individual) in value;
- 7) two firearms;
- 8) athletic and sporting equipment, including bicycles;
- 9) a two-wheeled, three-wheeled, or four-wheeled motor vehicle per licensed driver;
- 10) two horses, mules, or donkeys and a saddle, blanket, and bridle for each;
- 11) 12 head of cattle;
- 12) 60 head of other types of livestock;
- 13) 120 fowl; and
- 14) household pets.

Life insurance and certain types of retirement accounts are also generally exempt. If you have any other property, it could be subject to seizure and sale by a trustee who is appointed to look out for the creditors in your bankruptcy case. Property you might have which would not normally be exempt is land other than your homestead, extra cars, boats or four wheelers, cash, or money sitting in your checking or savings account at the bank.

### *Under what chapter can I file?*

#### Chapter 7 Bankruptcy

Chapter 7 of the bankruptcy code creates an estate, which is established for the benefit of creditors. The purpose of the estate is to preserve and orderly liquidate the nonexempt assets of the debtor. After the trustee investigates the circumstance which led to the debtor's insolvency, the debtor is forgiven (discharged) from

its debts. The debtor must receive credit counseling prior to filing a bankruptcy petition.

A trustee is appointed by the U.S. trustee's office after Chapter 7 papers are filed with the court. The trustee investigates the financial affairs of the debtor and takes control of the nonexempt property within the debtor's estate. The trustee's role in the case is to collect and liquidate property of the estate and distribute any cash to creditors. The trustee takes possession of all of the debtor's non-exempt property after the case is filed. The debtor's creditors are paid from the non-exempt assets of the bankruptcy estate. The nature of the debtor's exempt property varies by jurisdiction and by state but typically includes a portion of the equity in the debtor's primary residence as well as other personal items.

There are special rules which prohibit certain debtors from discharging their debts through a Chapter 7 bankruptcy case. Under these rules, a debtor may not file a petition under Chapter 7 if the relative income of such debtor exceeds the state median income for an individual taxpayer or that of a family of two, three or four family members within the State of Texas. If these rules apply to the debtor, a presumption of abuse occurs, which must be rebutted by the debtor. If the debtor fails to rebut the presumption, the debtor will be required to file a case under Chapter 13.

Chapter 7 cases typically last 60 to 90 days unless the trustee uncovers fraud or a creditor files an objection to discharge in the case.

A debtor is entitled to receive a discharge of all debts except those debts incurred by fraud, embezzlement, larceny, a domestic support obligation, willful or malicious injury to the property of another entity, death or personal injury caused by the debtor's operation of a motor vehicle while intoxicated, or the debtor's failure to pay restitution under certain criminal restitution orders. An educational loan may not be discharged unless the debt imposes an undue hardship.

If a debtor transfers property within two years of the date of filing their case, the trustee may avoid such transfer. If the debtor made the transfer with the actual intent to hinder, delay, or defraud creditors, a creditor or trustee may ask the court to revoke the debtor's Chapter 7 discharge.

### Chapter 13 Bankruptcy

Chapter 13 of the bankruptcy code creates an estate, which is managed by a trustee appointed by the U.S. trustee's office. The Chapter 13 bankruptcy process is structured to allow wage earners to discharge their prepetition debts. The debtor may propose a plan to repay its debts over a period of three to five years. However, the debtor must commit all of its projected disposable income under the plan, and the plan repayment period may not exceed five years. The debtor must also receive credit counseling prior to filing a Chapter 13 bankruptcy case. To qualify for Chapter 13, an individual debtor's unsecured debts may not exceed \$336,900 and its secured debts must be less than \$1,010,650.

A Chapter 13 trustee is appointed by the U.S. trustee's office shortly after papers are filed with the court. The trustee must account for and administer all nonexempt property within the debtor's estate, investigate the debtor's financial affairs, collect payments from the debtor and make distributions to creditors.

The estate includes the debtor's income and any property acquired by the debtor during the case. Chapter 13 also allows the debtor to protect its interest in its primary residence and halts a pending foreclosure proceeding. Unlike Chapter 7, the debtor is allowed to bring pre-bankruptcy mortgage payments current over a period of time. However, the debtor must pay each of its post-bankruptcy mortgage payments as they come due. The nature of the debtor's exempt property varies by jurisdiction and by state but typically includes a portion of the equity in the debtor's primary residence as well as other personal items. The debtor will retain possession of its property so long as all projected disposable income is paid to creditors for the duration of the plan.

The debtor's income affects the amount each creditor is entitled to receive by extending the length of a proposed plan of reorganization. Under certain rules, if the debtor's income falls below the median state income tax guidelines, the plan may not exceed three years. Similarly, if the debtor's income exceeds the median state income tax guidelines, the plan cannot be less than five years.

A Chapter 13 debtor is entitled to receive a discharge of all debts except those debts incurred

by fraud, embezzlement, larceny, a domestic support obligation, willful or malicious injury to the property of another entity, death or personal injury caused by the debtor's operation of a motor vehicle while intoxicated, or the debtor's failure to pay restitution under certain criminal restitution orders. An educational loan may not be discharged unless the debt imposes an undue hardship.

## Chapter 11 Bankruptcy

Chapter 11 allows an individual debtor to reorganize its affairs. Estate property includes the debtor's post-petition income and any property acquired during the case. The debtor must also commit its future disposable income to the payment of its debts under a reorganization plan for five years unless all claims are paid in full. The debtor must receive credit counseling prior to filing its bankruptcy petition.

### ***I own a small business, but things are slowing down; what are my options?***

Unfortunately, some businesses fail, which rarely occurs right away or by one single event. The downward spiral towards insolvency is sometimes caused by management's lack of attention towards finding new customers, rapid expansion, and insufficient control on expenses (usually labor costs). In order to jumpstart cash flow and supplement efforts to locate new customers and cut costs, management should consider using the services of a turnaround consultant and/or bankruptcy counsel. Such steps should be considered sooner rather than later because the success of a reorganization

attempt depends largely upon the business' resources available to make change happen quickly and efficiently. Before analyzing whether bankruptcy would be an option, management must first understand the legal and tax consequences of each business type (sole proprietorship, corporation, partnership, limited liability partnership, non-profit, etc.).

To determine the appropriate course of action towards liquidation or reorganization, no matter the type of business, management must be able to address the direction it is willing to undertake. Reorganization can be attempted for any entity or sole proprietorship through Chapter 11 (for reorganization), or a liquidation of assets through Chapter 7. In fact, some businesses may choose to sell their assets through a more controlled Chapter 11 liquidation process. Sale through a bankruptcy is advantageous to potential purchasers because of the ability to sell assets free and clear of all liens and claims.

In the case of reorganization, management must be willing to invest the time, energy and resources into the reorganization process. Reorganization could free up cash from servicing debt, permit rejection of certain leases or contracts and prevent the sale of vital assets. However, the reorganization process requires significant time and expense to comply with bankruptcy requirements. Undoubtedly, most businesses fail to reorganize due to a lack of proper planning and adequate resources. Thus, seeking advice from reorganization and turn-around professionals early increases the ability to successfully reorganize, or liquidate in an orderly fashion to maximize value for creditors.



## ***Should I hire an attorney?***

Absolutely! Bankruptcy is a very technical and potentially complicated process. There are numerous disclosure requirements, official forms, and deadlines which have to be met. Failure to fulfill any of the requirements imposed by the rules can mean potentially serious consequences for you or your bankruptcy, including dismissal of your case with prejudice against re-filing in the future. Accordingly, it is always best to hire an attorney experienced in handling bankruptcy matters to file your case for you. If you do not have money to hire an attorney, then depending on your income level there are organizations which may file a bankruptcy case for you at no charge. The largest provider of such free legal services is Lone Star Legal Aid. Their website is located at the end of this pamphlet, and they have branch offices throughout the state. For more information, call 800-733-8394.

## ***I have successfully completed my bankruptcy case – now what?***

Congratulations - your debts have been liquidated and you're beginning a new financial future. Here are a few basics of fiscal responsibility to you begin life after bankruptcy:

- Pay yourself first. Set aside a portion of your income in a savings account. Do this as soon as you are paid to make it easier for yourself. 10% is a good starting figure, but save as much as you can without sacrificing necessities. Most importantly, start immediately, saving whatever you can.

- Build an emergency fund. Start by saving one full month's income, but aim to reserve at least 6 months living expenses to fall back on in case of unexpected job loss, illness, or other emergency.
- Clearly distinguish your necessities, priorities, and wants. Learn to live within your means. Eliminate waste. Avoid debt.
- Save, Invest, and Compound. Once you have a healthy emergency fund look to invest a portion of your nest egg at low risk. Money market accounts, CDs, bonds, and stocks are a few of the options available. A financial planner can show you how your wealth can compound over time - your local bank is a good place to begin.

These simple rules will put you on a track for prosperity after bankruptcy.

### **Suggested Reading:**

- *Think and Grow Rich* by Napoleon Hill
- *The Way to Wealth* by Benjamin Franklin
- *The Money Book for the Young, Fabulous and Broke* by Suze Orman
- *Minimum Payment Due* by Douglas M. Mobley

**CREDIT BUREAU/CREDIT REPORT INFORMATION:**

Annual Credit Report – Free report provided once per year:

[www.annualcreditreport.com](http://www.annualcreditreport.com)

Experian:

[www.experian.com](http://www.experian.com)

1-888-397-3742

Equifax:

[www.equifax.com](http://www.equifax.com)

Transunion:

[www.transunion.com](http://www.transunion.com)

1-800-888-4213

**GOVERNMENTAL AGENCY SITES:**

United States Trustee:

<http://www.justice.gov/ust/>

United States Bankruptcy Courts:

<http://www.uscourts.gov/bankruptcycourts.html>

Federal Trade Commission Bureau of Consumer Protection:

<http://www.ftc.gov/bcp/>

USA.gov Consumer Protection for Seniors:

<http://www.usa.gov/Topics/Seniors/Consumer.shtml>

Texas Attorney General Consumer Protection Information:

<http://www.oag.state.tx.us/consumer/index.shtml>

(800) 621-0508

Texas Office of Consumer Credit  
Commissioner:  
<http://www.occc.state.tx.us/>

**CONSUMER ADVOCACY SITES:**

National Association of Consumer Advocates:  
[www.naca.net](http://www.naca.net)

Ripoff Report:  
[www.ripoffreport.com](http://www.ripoffreport.com)

Consumerist:  
[www.consumerist.com](http://www.consumerist.com)

**OTHER IMPORTANT SITES**

Lone Star Legal Aid  
<http://www.lonestarlegal.org/>

State Bar of Texas  
<http://www.texasbar.com/>