Be a Bankruptcy Advisor, Not Just a Document Preparer

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Introduction

All too often attorneys forget they are legal advisors and not just processors of paperwork. It is important to listen to your clients with an open mind. Do they truly need bankruptcy relief? Is there a better alternative? Is there a reasonable solution to their financial crisis that does not require them to incur the costs, embarrassment, inconvenience, and stigma of a bankruptcy filing?

It is our role not only to guide clients through the bankruptcy process, but also to help them analyze their current, short-term, and long-term financial situation and assist them in reaching the best solution for them. As you counsel them, remember that legal advice is only one piece of a large and complex puzzle.

Developments in Chapter 7 Bankruptcies

The Spread of Chapter 7 Filings

Arizona is one of six states hit hardest by the economic downturn in the last two to three years. Last year, Arizona bankruptcies topped 40,000 for the first time. The most significant trend in Arizona is an increase in consumer debtor filing, notwithstanding the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). As real estate values plummet, and the housing industry continues to slump, Arizonans face a perfect storm of financial pressure.

By the enactment of BAPCPA, Congress wanted to decrease what it perceived as a high volume of Chapter 7 filings. Congress established what it believed were rigid standards and guidelines to discourage consumers from filing for Chapter 7 relief. However, the realities of the downturn in the economy created an economic catastrophe of increased unemployment and a struggling real estate industry, and consumer debtor bankruptcy filings have only increased in recent years.

Many people who are directly or indirectly involved in the real estate industry as contractors, subcontractors, suppliers, and real estate brokers have lost their jobs, and real estate investors have lost their life savings and have significantly increased their debt load. Our office has filed numerous cases of real estate investors who attempted to leverage the real estate boom of the early 2000s by purchasing a large number of investment houses. They have seen their investments tumble, and they face insurmountable debt loads. Recent statistics show that 50 percent of houses in Arizona are worth less than what is owed on them. Most Arizonans have relied on their home equity as their retirement nest egg; the egg has broken, and most Arizonans now face a likelihood of a long struggle to regain what was lost.

I estimate that over the last two to three years, half of the bankruptcies we have filed have been closely tied to the real estate crash, through either loss of employment or loss of capital. We have worked with many people trying to reorganize their finances or helped them simply discharge their debts and attempt to rebuild with a fresh start.

Many who invested in real estate have lost their investment, and the lending banks are much more aggressive in seeking deficiency claims. Arizona has an anti-deficiency statute that provides that lenders who have a purchase money mortgage (the mortgage used to acquire residential property of two and one-half acres or less) are not permitted to seek a deficiency after foreclosure; however, this protection does not apply to construction loans, land loans, or commercial loans, for which deficiency claims are permitted. It also does not apply to home equity line of credit (HELOC) loans, where homeowners pull equity out of their home to use for other purposes, such as buying other houses.

I have seen an increase in deficiency litigation in recent years. Some banks are willing to enter into settlement discussions, but others are not, so much of our work is simply trying to keep people out of bankruptcy by negotiating amicable resolutions of deficiency claims brought by lenders who had foreclosed on investment property and were seeking the balance due on the loans. Other debtors are still owners of property that is worth far less than the amount still due. We are now seeing an increase in foreclosures on commercial property, where the stakes are often far larger. We currently represent a number of debtors who own commercial property they were using for their own business. The businesses were tied to the real estate industry or were commercial properties for lease and were leased, perhaps in part, to other businesses that collapsed in the downward spiral.

The Impact of Unemployment Rates

I have heard the expression that employment is a lagging indicator of economic recovery. This means that the economy will recover for a period before unemployment rates will decrease. If this is so, bankruptcy is an even more exaggerated lagging indicator of economic recovery because people will begin to go back to work, but they will still be forced to carry the impact of having been out of work for months, or in some cases, years. If people have been out of work for six months, even if they go back to work, they will likely be unable to service their consumer debt, so even though they have a job, they are still unable to meet the financial burdens caused by the period of unemployment. They have increased their credit card debt to survive and have fallen behind on their mortgage.

During the time they were unemployed, these people may have gone through their life savings and used credit to pay their bills. Once they get a job, they can generally at least cover their living expenses, but are unable to service the increased debt. Creditors continue to be unwilling to negotiate, and credit card companies will increase interest rates at the moment of default and will not reduce them once the default is cured. Consumers who were able to service their consumer debt at 5 percent to 8 percent interest are without the capacity to service it at 30 percent.

Hopefully, a steady increase in employment will stem the tide of bankruptcy filings. If people can go back to work and stay employed, and if construction can rebound in the state, long-term economic stability is likely, and the volume of bankruptcy will decrease. Once this occurs, it will create synergy in the economy, which will have a national impact.

The Importance of Obtaining Proper Health Care

It is unclear how health care reform will affect bankruptcy, but I have seen many clients who are unable to provide their own health care. I do not currently see high medical bill bankruptcy cases, but many of my colleagues frequently work on these types of cases. As long as people do not carry health care, they are walking a tightrope of disaster. I encourage all of my clients to carry health care at the expense of almost everything else because of the potential disastrous consequences that can arise if they are uninsured and the difficulty of obtaining medical care if they are uninsured.

I represented a man who relocated his family from Illinois to Arizona to improve the family's quality of life. He was earning less money after the move and could not afford insurance for the ninety-day waiting period until he qualified for his employment health insurance coverage. On day eighty-nine, he suffered a massive heart attack and, in three months, exhausted his life savings and incurred another $75,000 in debt. He took a gamble and suffered the consequences. Another client incurred $500,000 of debt when his son needed a bone marrow transplant that insurance did not cover fully. Fortunately for that individual, I was able to lead him to several foundations that assisted him in seeing that the hospital was paid. Increasing health care costs are a major factor in the national increase in consumer debtor bankruptcy filings and will stay that way until we, as a country, solve the problem and find a way to stem the tide of increased health care costs.

Recent Changes in Bankruptcy Law

The Intricacies of Chapter 13

Prior to the 2005 changes in the Bankruptcy Code, Chapter 13 debtors could reduce their secured obligations on car loans to present value in a practice known as "cramdown." BAPCPA put an end to cramdowns on most car loans. Bankruptcy lawyers are familiar with the dangling paragraph in Chapter 13. If debtors have owned a car for less than 910 days, and the car is used for personal, family, and household purposes, and the loan to be adjusted was the loan used to purchase the car, the car loan cannot be modified, and the debtors must pay the car loan in full. This has had an impact on my practice because for some people, car valuation became a make-or-break issue when filing for Chapter 13.

Another addition to the code under BAPCPA has made it almost impossible for real estate investors to file for relief under Chapter 13. Prior law permitted a debtor to pay off a secured debt by providing for a "balloon payment"—a large one-time cash payment—at the end of a Chapter 13 plan. This allowed the debtor to pay off the debt during the life of the plan, as required by the code as it then existed. Congress added a new provision in BAPCPA regarding cramdowns. A secured debt, if to be modified and satisfied by payments, must be paid in equal monthly payments. 11 USC 1325(a)(5)(iii)(1) While we have questioned whether it was Congress's intent to impose this provision on real property loans and not personal property loans, the case law supports the proposition that the provision applies to all modified secured loans. The change in the law can be explained by the following example:

A debtor has an investment piece of real estate, such as a former residence, and $200,000 is owed, but the property is worth only $100,000. In the past, we would modify the lien holder on that property by having a thirty-year amortization schedule and balloon payment due at the end of the plan or interest-only payments with a balloon at the end. Congress made a change by precluding us from doing this, so instead, the debtor has to pay the $100,000 in equal monthly payments over sixty months, which is almost $1,700 per month without interest. In all likelihood, that type of large payment would be impossible for most consumer debtors. This section forces consumer debtors who have some investment real estate property, but who are under debt limits, to take drastic measures. Chapter 13 has been eliminated as an option for these people because the only way to modify and stretch out payments to secured creditors is to do it through Chapter 11, where the clause does not apply. We have already converted several Chapter 13 debtors to Chapter 11 because of this clause. The equal monthly payment provision in Chapter 13 has affected our practice. We are now close to confirmation in several of these Chapter 11 cases. It seems to be an extraordinary waste of time and resources to push these debtors into Chapter 11, which is usually more expensive and time-consuming than Chapter 13.

The Means Test

Every consumer bankruptcy practice is affected by the means test and its interpretation. Courts continue to struggle with its interpretation, despite some congressional leaders who continue to assert that the legislation is perfect and needs no adjustments.

For example, until this month there was an undecided issue of law concerning a debtor's entitlement to claim a car expense on the means test if the debtor did not have an actual car payment. The circuits were split on what would seem to be a straightforward question, but the language of the statute appeared vague. In *Ransom v. FIA Card Services NA* –S.Ct. - 2011 WL 66438 (U.S. 2011), the US Supreme Court has finally decided the question by affirming a Ninth Circuit decision that had held that the car payment deduction cannot be taken unless the debtor actually has a car payment. While the reasoning of the Court sounds logical, it leaves some debtors in an awkward position and can lead to results that were clearly unanticipated.

If a debtor has a car with one $250 payment left after filing for bankruptcy, the debtor will get the full allowance, less what is left on the sixty-month amortization of the one car payment that is left. Therefore, on the secured debt portion, we would take the one car payment and amortize over sixty months, and under the allowance section, we can deduct the balance of the allowance. However, if someone with an older car that must be replaced in five years does not get the allowance, we cannot properly provide for the eventuality of having to replace the vehicle. These debtors may be forced into Chapter 13 bankruptcies and be unable to replace the vehicle for another five years. What are they to do? Turn in the car and incur a new car loan immediately before filing so they can replace an old car and be eligible for Chapter 7 relief? Who benefits from that? Does the debtor with free and clear cars incur loans from friends or family members on cars to qualify for the allowance? In addition, if the allowance is denied, the need to replace the vehicle during the ensuing sixty months is not recognized.

While it seems like a relatively simple concept that one cannot claim an expense unless it actually exists, the legislation is not so clear. For example, a debtor can claim a medical expense allowance even if there are no such expenses. The means test remains a confusing and sometimes inconsistent road. Can a debtor claim a mortgage payment for a house he or she does not intend to keep? If the debtor is in arrears on the mortgages he or she does not intend to pay, can he or she still claim the costs of curing? What about pension contributions and pension loans? Charitable contributions? What happens to the debtors who show disposable income for Chapter 7 purposes, but not for Chapter 13? Are they ineligible for both?

Understanding Lanning

Another significant case the Supreme Court recently ruled on is *Hamilton v. Lanning* 130 S. Ct. 2464, 177 L. Ed. 2d 73 (2011). The facts in *Lanning* may seem somewhat unusual; however, many debtors fall into similar, if not as extreme, circumstances. The debtor in *Lanning* received a large severance package from her employer within six months prior to the filing of her Chapter 13 case. The means test calculation was skewered as a result. Based on her income and expenses at the time of the filing of her petition, her disposable income was less than $200 a month. Based on her means test disposable income, her plan payments would have been in excess of $700 a month. There was no dispute that her current income would not support that payment and that the only reason her disposable income was so high under the means test was that she had received the large severance payment from her prior employer.

The question in the case is about the means test and what it really means for bankruptcy courts, especially in Chapter 13. Does the court have discretion to look at a debtor's financial condition at the time of the filing of the case or the confirmation of the plan, or is the means test a rigid formula that can be modified only in unusual circumstances? We have to determine whether it means that the Supreme Court is telling bankruptcy courts that they can have discretion in Chapter 13 cases to lean more on schedules I and J at the time of confirmation of a plan, rather than to look at the means test to determine what plan payments should be. This is a significant decision, depending on how it is interpreted. The court stated that the means test was a "starting point" in the analysis of disposable income.

The *Lanning* case may be significant if the bankruptcy courts are now granted expanded discretion in the confirmation of Chapter 13 cases. How will this decision influence the creditor bar in the preparation of objections to confirmation? It is also unclear where to draw the line. Once the court determines that the test cannot be applied to a case such as *Lanning*, has the Pandora's Box of discretion been opened? What constitutes an unusual circumstance? How large a decrease or increase in disposable income is enough to trigger the *Lanning* analysis? If a debtor has increased earnings or decreased expenses at the time of filing, should the court disregard the means test and simply examine income and expenses at the time of confirmation? The *Lanning* decision is a double-edge sword. Sometimes BAPCPA works in favor of the debtor because looking back at the last six months, a debtor may have had little income, but post-petition, the income may have significantly increased. The *Lanning* decision says to the bankruptcy court system that we should not lock in a means test to Chapter 13 cases, but instead, we should look to the traditional analysis of where the debtor is at the time of confirmation.

This is consistent with some of the law that has evolved in Chapter 13 and the means test. We no longer count as an expense for confirmation purposes a second mortgage on a house that will be stripped and not paid as a secured debt in the plan, even though it technically is an expense the debtor is contractually liable to make on the day of filing. Under a Chapter 13 case, it does not count under the means test because the debtor will not be paying it going forward.

Additional Considerations in Current Case Law

I am currently litigating a case before the Bankruptcy Appellate Panel involving a divorce/bankruptcy issue. BAPCPA added a provision under 362(b)(2), which provides that the automatic stay does not apply to the withholding of income that is property of the estate or property of the debtor. 362(b)(2)(C). Under BAPCPA, post-petition income for an individual Chapter 11 debtor remains property of the estate. Under Chapter 13, a debtor's income was always property of the estate. The courts that have interpreted this new section have determined that this simply allows existing wage garnishments to stay in place in Chapter 13 cases after the case was filed. In my case, the bankruptcy court held that the new section permitted the non-debtor spouse to initiate an action to hold the debtor in contempt for non-payment of child support without first getting relief from the automatic stay. 11 USC 362(b)(2)(A) provides exceptions to the stay relating to domestic relations litigation. We are arguing that initiating an action to enforce a support order is not one of those exceptions.

Analyzing BAPCPA

The changes in the economy and their impact through the changes in bankruptcy law can affect all people. Ten years ago, there was a split in the circuits on whether debtors could cram down a primary residence in a Chapter 13 or Chapter 11 case. In the Ninth Circuit, debtors could cram down (*In re Hougland,* 886 F.2d 1182 (C.A. 9^{th} 1989)), but in the Fifth Circuit the debtor could not (*Nobleman v. North American Savings Bank,* 968 F.2d 488 (C.A. 5^{th} 1992)). The Nobleman case went up to the Supreme Court, which determined that debtors could not modify a lien secured only by their residences. *Nobleman v. North American Savings Bank,* 508 U.S. 324, 113 S.Ct. 2106, 124 L.Ed. 2d 228 (1993)). Congress codified this in Chapter 13, and BAPCPA extended this to individuals in Chapter 11. The result was that debtors who own investment real estate rental houses can cram down those assets to fair market value, but debtors who own only their primary residences cannot.

Current Issues with BAPCPA

In the last presidential campaign, the cramdown issue became significant. Both Senator John McCain and President Obama campaigned on platforms to allow homeowners to modify their mortgages in Chapter 13. After the 2008 elections, Congress passed a series of financial bailout bills. One bill, which passed the House but failed in the Senate, would have allowed homeowners to modify their home mortgages in Chapter 13—in effect following the prior Ninth Circuit law. This measure failed to pass the Senate. The impact of this is the seemingly backwards result that allows investors to modify investment property mortgages, but denies that right to homeowners dealing with their own home loans. Philosophically, this is backwards thinking; if we want to spur the economy and give homeowners some help, we should allow them to modify their mortgages to fair market value to spur the real estate market.

More people own private residences than own investment properties, so mortgage companies were willing to take the hit on investment properties, rather than residential properties. While this is not part of BAPCPA, it is certainly part of the bankruptcy process and has been for a long time. This is not logical because it protects the investor, rather than the homeowner, and the whole premise of the Bankruptcy Code was to give some relief to the honest but unfortunate debtor. Instead, this provision gives relief to the speculator, who has no disadvantage in his investment.

In my opinion, the Bankruptcy Code prior to 2005 worked well, and the current means test is a result of overly aggressive lobbying by the credit industry. It was created to stop high-income debtors from filing for Chapter 7 bankruptcy, but in reality, they have trapped middle-class citizens whose salaries are over the median income. These people are on salaries, and they may be trapped in the means test, while people who are entrepreneurial and go from high to low income on a regular basis will not face the presumption of abuse, since their incomes may be in a temporary decline.

For example, some entrepreneurs may have a lull in income for the last six months, so they can file for Chapter 7 and do not have consumer debts because they are high-end debtors with real estate guarantees, taxes, or commercial loans. When these types of clients make money, they are capable of paying heavy debt, but during a six-month lull, they are eligible for Chapter 7, while salaried people who may have fallen on hard times are now obligated to repay debt. They are not the ones who were "abusing" the credit system (assuming anyone was). The means test is an over-reaction that seems designed to strip bankruptcy court judges of discretion in analyzing who is guilty of abuse and who is simply an honest but unfortunate debtor who has fallen on hard times and is in need of a fresh start.

The Problem of Micro-Managing and Social Engineering

Congress has mandated that all Americans live according to certain standards. They can own as big and expensive a house and drive as expensive a car as they wish, but cannot spend any money on "discretionary" expenses, such as music lessons. Congress has ordained how each American should spend his or her money if they have creditors. I do think that this form of social engineering was what Congress wanted when the means test was imposed.

For example, if an over-median-income debtor has a child who is musically gifted, it makes more sense that the debtor can choose to eat beans, drive an old car, and live in a smaller, affordable house so that the child can have piano lessons. Unfortunately, debtors are locked into the means test, which sets out that money can be spent on houses, cars, and charitable institutions, but cannot be spent on piano lessons. This is micro-management by Congress and is especially interesting considering that it was passed by a Republican Congress that does not believe in big government or government intervention into the lives of Americans. It has forced people to live to a common standard.

Congress could have provided that a certain percentage of income must be committed to debt repayment if a debtor earned more than a floor amount. This would allow debtors to determine how they want to spend their income. Some families may feel strongly about private education for their children and are willing to make sacrifices for that privilege. Others want to provide opportunities for their children in sports, arts, sciences, or other "frills." They are denied the right to make those decisions.

The means test simply imposes specific lifestyle decisions on Americans. Instead of imposing strict guidelines for living expenses and forcing the courts to make lifestyle decisions for people, Congress could have simply mandated that a certain percentage of income must be devoted to debt repayment, and the decision on to spend the rest of the money should be the debtor's decision. Instead, Congress created this elaborate means test and decided to set a standard of living, rather than allow debtors to create a new life under their own circumstances and decide their own priorities. When people lose the discretion to make family decisions, something is not right.

The Common Consumer Bankruptcy Client

Clients file for relief under Chapter 7 for a variety of reasons, including lost jobs and lost homes. This has remained the same in recent months. Every now and then, I work with older couples who are now taking care of adult children and grandchildren because of the social and economic impact their children have faced. Most of the time, they do not come to me with their own problems, but are forced to deal with their children. They are generally up-to-date with their own debts, but were living on a tight margin, when suddenly, their adult children or grandchildren moved in with them. Instead of a family of two seniors, they are now dealing with four or five additional people, but are trying to live on the same budget. There is simply not enough income to meet the expense needs of the extended family.

Rising unemployment has certainly led to the increase in consumer bankruptcy filing. Families have exhausted life savings, dipped into retirement funds, and liquidated assets to meet growing debt loads. Eventually, for many people, the house of cards tumbles down, and all that is left is a pile of debts with no ability to pay.

Legal Strategies for Chapter 7 Attorneys

Client Strategies

I generally describe bankruptcy as the "port of last call," and people should always try to avoid filing. I believe that debt counseling is a great idea for clients and have always encouraged them to seek strategies for debt repayment without having to file for bankruptcy.

I am distressed about some of the abusive practices that exist when companies advertise that they can reduce an individual's credit card debt to 35 percent by giving their money to a certain credit card relief company. These companies are often not reputable, taking a debtor's money and never negotiating with the creditors. What often happens is that the "relief" company simply tells the debtor to stop paying bills and send the money to the company, which promises to "hold" the money and then negotiate with the creditors. The "relief" company takes the money but does nothing. Eventually, the debtor is sued by one of the credit card companies and is forced into bankruptcy. I have seen trustees try, without success, to get the money back from the "relief" company.

On the other hand, I have referred many clients to reputable debt counseling services that have been able to assist debtors in working out plans with their creditors in which monthly payments are made through the counseling service and sent on to the creditors. While it may take a number of years to work through the process, it is often in a debtor's best interest to do so. Sometimes the "forest" of debts and financial pressure is so large that the client loses track of the ability to simply work things out with the various "trees." A good credit counseling company can do that for the right debtor. They can provide a good service, and I have had many clients who have been successful in obtaining counseling.

When people have disposable income, I encourage them to try debt-counseling services before filing for bankruptcy, and if they have equity in their homes, they should consider whether they want to put that at risk to avoid bankruptcy. I do not encourage people to borrow against their retirement money because I believe it is more risky.

While debt counseling can be a worthy endeavor, one of the main problems my clients face is that the credit card companies are not prepared to negotiate. Even though the Bankruptcy Code encourages negotiation by limiting creditor claims if they do not enter into good-faith negotiations, my clients find it impossible to get through to anyone who can make decisions. They face the same hurdles with mortgage companies when they try to negotiate loan modifications. Trying to find someone on the other end of the phone who is a successful decision-maker is difficult to do.

Successful Chapter 7 Cases

We begin discussions with our clients by trying to get a good picture of their income, expenses, assets (especially to the extent that they have non-exempt assets), and liabilities. We talk about whether they have assets that will be taken by a trustee and liquidated to pay creditors and whether they have disposable income. We look at whether they have primarily consumer debt, which would make the means test analysis necessary. Many of our clients are significantly upside-down on real estate and have been unemployed. These individuals are not means test-eligible because either their living expenses far exceed their income, or they do not have primarily consumer debt.

The vast majority of our clients are either investors who have fallen on bad times with primarily non-consumer debts or clients who have been out of work or under-employed for an extended period and do not have disposable income. For the people who do not have disposable income, getting them through a Chapter 7 may not fix their underlying problem. It may eliminate existing debt, but in the end, it may not be beneficial for them if they cannot go back to work and meet regular living expenses. For them, bankruptcy is not a total “fix.” They may erase debt but have not resolved the underlying problem of lack of income.

We send an intake form to our clients before our first meeting. They bring the completed form in so they do not have to spend time filling it out when they get to my office. This gives me the information I need to review assets, liabilities, income, and expenses, so I can spend our time together discussing their specific situation and their non-bankruptcy options. We then talk about their options under bankruptcy and the process under BAPCPA. This involves discussing the means test analysis, debt counseling, Chapter 7 and Chapter 13 trustee responsibilities, and my clients' expectations of their involvement in the system. In addition, we talk about what they will have to provide to trustees and in turn, what the trustee will need to see to administer the case.

Most cases go through relatively simply. A trustee asks for some basic information, and the debtors can go through the rest of the process without too many bumps in the road. Generally, I do not have too many creditors show up at meetings of creditors, so they do not usually have too many objections. We occasionally have exemption objections from trustees who need further information to evaluate a debtor's claim to an exemption (a claim that they can keep an asset and not surrender it to the trustee for liquidation.) We will periodically litigate an exemption dispute with a trustee but usually can resolve the matter by simply providing information.

A more interesting dispute arises from a debtor's desire to "abandon" a non-exempt asset from a bankruptcy estate. Trustees are far more inquisitive into assets that debtors want to keep—assuming that the asset must have some value if the debtor wants to keep it. These matters often involve a business the debtor owns, and the trustee simply needs to determine that the business has no "going concern" value. This process can often take a number of months to resolve.

Sometimes a trustee or a creditor needs additional information to evaluate a debtor's claims to exemption or abandonment or to evaluate whether a creditor wants to pursue a claim against the debtor. We will periodically get requests for examinations under Rule 2004, so a trustee or a creditor can take a longer examination of the debtor than would be available at a meeting of creditors.

For the most part, creditors with collateral simply want the collateral back. We see few objections to dischargeability of debt or complaints to deny a discharge. Most of the clients have little direct contact with the federal court system and never see a judge. They go to court to see a trustee, and we try to explain to them that it is nothing to be embarrassed or shamed about. For most of my clients, the biggest issue is getting their own emotional issues under control. They are always concerned about whether the bankruptcy will be in the newspapers, whether their employers will know, and whether a trustee will come to their house. People are very much afraid and ashamed of what has happened to them.

Helping Clients Achieve Their Goals

Most of my clients are victims of the economic downturn or were people who made bad investment decisions because they believed that real estate was a safe investment. They are not people who were being deliberately reckless, but instead, only made bad decisions. I try to tell them that bankruptcy is a socialized cost, like health care and car insurance, and that we all pay higher car insurance rates because there are drunk drivers and bad drivers. We pay higher health care costs because there are smokers and other people who are reckless with their health. We pay higher credit card interest rates and annual fees because of the people who are credit risks.

The institutional creditor that gets its debt discharged is able to pass it off on the rest of society; the banks and credit card companies pass those losses on to the rest of the public by increasing rates, fees, and prices. When my clients are sleepless at night because of the worry that accompanies the bankruptcy process, I tell them that credit card companies are not losing any sleep over it, and the banks and credit card companies will not lost any money over it. The rest of society will pick up the tab, just as my clients pick up the tab for people who are bad drivers or health risks.

Answering Common Client Questions

Clients are always concerned about whether they make too much money to file for bankruptcy. While they may make more money than the median income, which puts them into the category of having to go through the means test, they are not necessarily prohibited from filing for relief under

Chapter 7. Instead, we begin the process to determine whether they have disposable income. Clients hear all sorts of crazy things about bankruptcy, so they are confused by the process and have heard things that are simply not true. We spend time talking about exemptions—the assets that are protected from creditors under the bankruptcy laws and under applicable state and federal law. Each state has its own particular laws, and some use only federal exemptions. When clients are concerned that a trustee will come into their homes and pull out all of their furniture, it is important to take the time to thoroughly explain exemption laws. Arizona, where I live, is what is called an opt-out state, which means that an Arizona resident who files for bankruptcy will claim the exemptions that are available under state law. We spend time discussing what is exempt and what is non-exempt.

In the first meeting, we spend a significant amount of time talking about the client's assets and methods for determining the value of certain things. This is a common question because clients do not understand how bankruptcy courts look at values. When we are looking at doing reorganizations, we are far more interested in real estate values because we may be attempting to reduce the principal balance of the debt.

The Best Time to File

Most of my clients file when they are at risk of losing something. For example, if they are about to have their wages garnished or if they are at the economic bottom but believe they are turning a corner, I would rather see them file at that point than when they are on a full downward spiral because they could be incurring more debt. For people who have been incurring medical bills, I want to make sure that they have completed whatever medical treatment they are going through or that they have insurance or an additional way to pay for future medical costs. The last thing bankruptcy lawyers should do is put clients into bankruptcy and have them incur another $50,000 in medical bills after the case is filed. Those new debts cannot be discharged if they are incurred after the case is filed.

If the clients "bottomed out" and will not incur any more debt, it may be the right time to file. For some clients, filing is based on timing. For example, if they have certain tax obligations, they may be able to discharge those debts if they are more than three years old. We may look at a local real estate market and try to determine whether values are increasing or have stabilized. If a client has recently had a significant change of income or expenses, we need to determine how this change will affect a means test analysis.

In the past, some people inquired about filing for bankruptcy in a different state for strategic purposes. BAPCPA did away with many of these issues by implementing the obligation of living in a state for two years before being able to claim exemptions. However, some clients may still want to move to certain states because different exemptions apply in different parts of the country, even though they cannot file for bankruptcy.

Protecting Assets under Property Exemption Rules

Exemption planning—converting non-exempt property to exempt property shortly before filing for bankruptcy relief—is a tightrope. There is a thin line between exemption planning and fraudulent conveyances. I recently won a case in bankruptcy court in which a debtor had exempt assets and borrowed money from a family member. The debtor then gave the family member a lien on the exempt assets and used those funds to pay back loans from a pension plan. The Office of the United States Trustee filed a complaint saying that this conveyance was done with the intent to hinder, delay, or defraud creditors. The court ruled in our favor, but the debtors had to endure the time and cost of litigation. This will continue to be a difficult issue, and bankruptcy attorneys should be aware of the potential complications that can arise when discussing exemption planning and fraudulent conveyances with clients. Bankruptcy attorneys should seek to advise their clients of the risks and let them know their options.

Two cases in the Eighth Circuit were decided on the same day. Both cases had the same three-judge panel, and in one case, called *Hanson v. First National Bank in Brookings,* 848 F.2d 866 (CA 8th 1988), the debtor sold assets to his children and retained possession of some of them. He then used the money to live and ultimately filed for bankruptcy. The court held that this was permissible. In the other case, *Norwest Bank Nebraska v. Tvetin,* 848 F. 2d 874 (CA 8th 1988), the debtor liquidated non-exempt assets and bought an exempt annuity with the proceeds. He then filed for bankruptcy, but the court determined that this was not permissible. It is unclear why the court held differently in these two similar cases, but it exemplifies how difficult and complicated this area of law can be.

The Unique Nature of American Bankruptcies

The most significant challenge that clients face is surviving this economic landscape. A problem in our culture is that Americans are not capable of deferring gratification. In other countries, people do not buy consumer goods unless they can pay for them; in this country, this is not the case. However, our national economy depends on people financing the purchase of large consumer goods. Consumers' inability to buy such products unless they could pay for them would have a drastic impact on employment in our country. For example, GM may not have been able to survive its own bankruptcy if people could not finance cars. If people could not finance washing machines and refrigerators by credit, our manufacturing and employment base would be different.

To some extent, our culture depends on deficit spending by consumers, but there is a fine line between responsible and irresponsible use of credit and appropriate risk-taking. In the last several years, we have seen the economy tip over the edge possibly because of reckless mortgage practices. We are now dealing with the consequences of reckless use of credit by consumers and by the mortgage industry.

There is responsible use of credit and irresponsible use of credit. Credit counseling is important. I would like to see credit counseling implemented into our school system so high school graduates will know how to be responsible citizens and understand family budgeting issues, along with money management issues.

The credit card industry should have put a means test on the front end of their relationships with their customers, rather than the back end. Credit card companies should do some analysis before providing cards to people who do not have the financial capacity to incur thousands of dollars in credit card debt. Credit card companies should assume some of the responsibility for the amount of credit card debt in this country. They have recklessly provided credit to customers who did not have the capacity to handle the debt.

Credit card companies charge high interest rates and earn enormous profits from those who are unable to pay. Having made the large profits, they then lobbied Congress to make consumer bankruptcy more difficult; yet they assume no responsibility for helping create the problem in the first place.

I would like to see a means test at the front end of obtaining a credit card. Even though consumers must ultimately assume responsibility for their own conduct, credit card companies have been known to create irresponsible advertisements that encourage consumers to spend money on credit they do not have. Credit card companies should not tell consumers to live lives they cannot afford. The fault for debt is a shared one.

Conclusion

Consumer bankruptcy attorneys should stay current. This is a dynamic field, and there are many great update services, organizations, and industry groups for bankruptcy attorneys to join that provide updated and current information. Although bankruptcy is a complicated area of law, as long as lawyers remain up-to-date, they will be successful.

When new clients come in seeking legal help, lawyers must make sure they analyze the entire situation and determine whether bankruptcy is the best answer for the client. Bankruptcy lawyers need to be advisors, not simply document preparers.

Key Takeaways

- Refrain from telling clients about which direction to take. Instead, lay out all the available options so that your client can make an informed decision on which direction to move. Your client must be able to live with the consequences of his or her decisions.
- Help your clients sort out the emotional issues that inevitably accompany the bankruptcy process. This can be the most difficult aspect of working through the process because people are always concerned about the embarrassment, fear, and shame they believe they will have to deal with. I have often advised clients to seek psychological counseling if they cannot cope with the perceived stress of filing bankruptcy.
- Stay current with bankruptcy legislation and case law, and find local networking opportunities among practitioners. Think about joining local or national bankruptcy organizations.
- Remember that bankruptcy attorneys must be advisors, not simply document preparers.

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