

The advantages of bankruptcy

The key benefit of bankruptcy is the discharge of debts, which enables a debtor to start over with a clean slate. However, there are many other advantages, including protection of property and an automatic stay.

Discharge of most debts

The principal goal of most bankruptcies is to have most unsecured debts discharged. The bankruptcy discharge totally eliminates any personal obligation to pay many types of debts. (A few types of debts are not dischargeable. Also, if a creditor has a lien on property taken as collateral, the debt owed to that creditor may still have to be dealt with after bankruptcy because the lien will, in some cases, survive.) For most debtors, bankruptcy is a relatively quick and easy way to end the creditor harassment, hardship, anxiety and marital stress normally associated with debt overload.

Protection of property and income from unsecured creditors

Bankruptcy is often the only sure way to protect a debtor's property from unsecured creditors (those who did not take a lien on property as collateral at the time of the transaction). Bankruptcy may provide total protection for a home, car or other vital property.

The amount of property that debtors can protect from creditors through exemptions in bankruptcy is, in many states, far greater than the amount that they can protect under the state law execution processes through which creditors attempt to seize debtors' property or income. Even where state execution exemptions are similar to or better than the federal bankruptcy exemptions or where the federal exemptions are not available, bankruptcy allows the debtor to avoid having to assert the exemptions repeatedly in response to the execution attempts of different creditors.

Normally, bankruptcy also serves to prevent any garnishment (attachment or seizure) of wages or other income after the petition is filed. This, in turn, may protect an individual's job if the employer does not favor multiple wage garnishments. Even attempts to reduce Social Security or other public benefit payments to get back previous overpayments should be preventable by a timely bankruptcy petition.

Tools for eliminating or modifying secured debts

A bankruptcy discharge does not, by itself, eliminate the liens on a debtor's property that secured creditors have obtained before bankruptcy. However, other provisions in the Bankruptcy Code do give debtors mechanisms to deal with most secured creditors. Many types of liens may be eliminated or reduced, either because they impair exemptions or because they are on property that is worth less than the liens. In a Chapter 13 case, payments on most other secured debts can be lowered, and a reasonable time can be gained to cure almost any defaulted secured debt. Often, one or more of these aspects of bankruptcy enable a debtor to retain a home, car or furniture that would otherwise be lost.

Automatic stay

The most valuable feature of a bankruptcy is sometimes the automatic stay, which the debtor gains instantaneously on filing a petition. The stay is an automatic court order that prohibits all

sorts of collection attempts by creditors, allowing the bankruptcy to proceed in an orderly fashion. It forces an abrupt halt of most creditor actions against the debtor, including repossessions, garnishments or attachments, utility shutoffs, foreclosures and evictions. Many of these can thereafter be permanently prevented. The stay is also an effective way (though hardly the only way) to end creditor collection efforts. Creditors who violate the stay risk contempt of court, money damages and attorneys' fees. Beyond all this, the stay gives the debtor a breathing spell, time to sort things out.

Other protections available through bankruptcy

Bankruptcy may offer the only possible way for an individual to keep or regain a driver's license that is subject to revocation because of an unpaid debt arising from a motor vehicle accident. This, in turn, may mean employment and income for the individual's family. In some cases, bankruptcy may mean freedom for a debtor who might otherwise be incarcerated for failure to pay support obligations or as a result of a contempt proceeding involving some other debt. The Bankruptcy Code also protects the debtor from many types of discriminatory actions by government bodies and private employers on the basis of unpaid debts discharged in bankruptcy.

The disadvantages of bankruptcy

Despite all of the advantages that bankruptcy may provide, there are many valid reasons for choosing not to file a petition. Some of these concern problems in the cases of particular debtors; others relate simply to the fact that bankruptcy is not the only means to address the debtor's legal problems and may not be necessary.

Loss of property

One consequence of a Chapter 7 bankruptcy is the loss of nonexempt property or its value in cash. This is not a problem for many debtors because consumer debtors rarely have any nonexempt property. Except in those few states that have low exemptions and have passed laws making the federal bankruptcy exemptions unavailable to their residents, the amount of property a debtor is allowed to keep is generous enough to protect the property of most nonhomeowners and many homeowners. Only debtors with equity of substantially more than \$21,000 per debtor in a home, \$3,225 in a car or \$10,775 in household goods and certain other property are likely to have problems under the federal exemptions. Even in those cases, a Chapter 13 bankruptcy often presents a viable alternative through which debtors may retain all of their possessions.

Effect on credit and reputation

A bankruptcy will be part of a debtor's credit history for as long as the law allows, that is, 10 years under the Fair Credit Reporting Act. This means that anyone who requests a credit report will be informed of the bankruptcy filing. The effect this will have on future credit cannot be predicted, but it is an understandable concern of many people who are considering bankruptcy.

There is no definite response to this concern. However, debtors who owe substantial amounts, especially if they are in default, already have poor credit ratings. In the eyes of some creditors, a bankruptcy that wipes the slate clean will be an improvement. Not only will the potential customer be free of other financial obligations, but he or she will also be unable to obtain a Chapter 7 discharge for another eight years in most cases. For these reasons, some creditors have been known to actively solicit recent bankruptcy debtors.

As bankruptcy has become more prevalent in the United States, creditors have increasingly considered it only one factor in their decision about granting credit, and most have chosen not to automatically exclude the ever-growing number of people who have filed a bankruptcy case. Even mortgage lenders are often willing to disregard a bankruptcy that is more than a few years old.

Bankruptcy's effect on a debtor's reputation in the community is almost always imperceptible. In a small town, however, especially if debts are owed to local people, the stigma of bankruptcy cannot be entirely discounted. The potential harm can only be evaluated locally, on a case-by-case basis, and weighed against the advantages that bankruptcy offers. Again, the possibility of voluntarily paying selected debts should not be overlooked if it would ameliorate the problem.

Possible discrimination after bankruptcy

Closely related to the problem of reputation is that of discrimination against debtors who have filed bankruptcy cases. To a large extent, the Bankruptcy Code alleviates this problem.

Government bodies generally may not discriminate on the basis of a bankruptcy or because of a debt discharged in bankruptcy. Thus, a housing authority or grantor of government assistance benefits cannot deny benefits to a person based on previously discharged debts. Similarly, utilities may not deny service based on a bankruptcy or discharged debts, though they may demand a security deposit for continued service. Private employers may not discriminate with respect to employment or terminate employment based on bankruptcy or discharged debts. Debtors can rest assured that the law protects them in this regard and that they will be able to enforce their rights in court, if necessary.

However, the distinction between discrimination based on bankruptcy or discharged debts and discrimination based on future financial responsibility should be clearly understood. That is, even creditors who are precluded from discrimination based on bankruptcy may refuse new credit or other services if the refusal is properly based on other considerations.

The law regarding discrimination by other private entities, such as creditors who provide essential services, is not as clear. It should be pointed out that this type of discrimination is extremely rare, especially in urban areas where many providers of goods and services are available. It would be most likely to occur in a small town, where only one merchant offered a particular product or service. In that case, if it could be shown that later discrimination was a prohibited attempt to coerce payment of the debt, the debtor could go to court to seek damages because the creditor violated the bankruptcy laws.

Again, the situation can best be assessed locally, on a case-by-case basis. Discrimination against debtors who have filed bankruptcy cases is normally not a problem, but if a debtor is in doubt, he or she should consult an experienced bankruptcy attorney.

Cost of filing a petition

Besides any attorneys' fee, which will be hundreds of dollars, bankruptcy carries an out-of-pocket cost of at least \$284-\$299 for the court fees and fees for a prebankruptcy credit counseling briefing and a credit education course required after the case is filed. Some of these

fees may be waived for people too poor to pay them. Other fees may raise this figure somewhat. In a Chapter 13 case, for example, the trustee is usually entitled to a commission of up to 10 percent of the payments made through the plan. In some cases, various utilities may require security deposits to ensure continued service.

These costs, like the less tangible costs, must be weighed when deciding whether to file a bankruptcy case. Where the debts are not large or troublesome, it may simply not be worthwhile to spend the amount necessary to eliminate them.

Failure to solve the underlying problem

In some cases, bankruptcy is simply the wrong tool to use, and none of the advantages will be realized. One such situation is that of the debtor whose debts are fully secured by security interests or other liens on property that cannot be impaired through bankruptcy and who does not have sufficient income to remedy a default even with all of the help bankruptcy provides. Unless there is some advantage to litigating in bankruptcy court, bankruptcy will not solve this debtor's basic problems. At most, it may discharge the debtor's personal liability for the debts and gain the advantage of the automatic stay for a month or more. Although in some cases this could be worthwhile, in most it will not ultimately benefit the debtor.

The problem of debtors in this predicament is often that their current expenses exceed their income. Because bankruptcy (except for Chapter 13's ability to stretch out or reduce certain types of short-term expenses) basically deals with assets and liabilities, it does not address this problem directly in most cases.

The opposite situation can also sometimes cause problems. If a debtor has substantial and valuable nonliened property that cannot be exempted, a premature bankruptcy will generally hasten property loss rather than prevent it. Because unsecured creditors must sue the debtor to obtain judgment liens or levies on the debtor's property, loss of the property outside bankruptcy may be quite slow. On the other hand, liquidation of nonexempt property generally occurs quickly in the bankruptcy process. And, because unsecured creditors are entitled to the present value of nonexempt property in Chapter 13, a case under that chapter would be quite costly. In this situation, the best option is probably to wait at least until execution on the property appears imminent, unless the debtor can afford the necessary Chapter 13 case.

Some debtors may be barred altogether from filing a bankruptcy for some period of time. An individual cannot file if he or she had a previous bankruptcy case dismissed in the past 180 days and the dismissal was (1) for willful failure to abide by court orders or to appear in court in proper prosecution of the case or (2) a voluntary dismissal following a request for relief from the automatic stay of section 362 of the Code.

Finally, some debtors may stand to gain little from a Chapter 7 bankruptcy because they cannot receive a discharge due to a prior bankruptcy. For these people, the prospect is somewhat brighter. In most cases, a Chapter 13 case can still provide significant relief.