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CHAPTER 13 BANKRUPTCY IN A NUTSHELL

Bankruptcy laws provide individuals with two main avenues to debt relief: Chapter 7 and Chapter 13. There are pros and cons to both options and which one you want will depend on the types (and amounts) of debt that you have, your assets, and your goals. Some people think that a Chapter 7 is better or cheaper than a Chapter 13, but that's not true. Actually, Chapter 7 usually costs more up front (because your lawyer must be paid in full before the case is filed because they are not allowed to be a creditor). In a Chapter 13, on the other hand, your attorney is paid as part of your Chapter 13 plan over the next 3 to 5 years. But, remember, you're getting legal assistance for those 3 to 5 years instead of the 3 to 5 months that a Chapter 7 lasts. There are great benefits to having that attorney on your side for several years.

Why Should You Consider Chapter 13 Bankruptcy?

Everyone should consider both Chapters 7 and 13. Don't let someone (even an attorney) push you into one or the other because that's all they do or because that's what they know best. The only way to know for sure which chapter is best for you is to have a detailed consultation with an experienced attorney. That attorney may need to review some of your financial documents, deeds, etc. or even pull your tax return transcripts in order to give you an accurate assessment of which chapter is best for you.

Catching Up on Back Payments

A Chapter 13 is a great option if you need to catch up on back payments on secured debt (such as a house or a car). Often, we will file a Chapter 13 plan to stop a foreclosure or to give our client time to work on a loan modification. We can propose a plan that has you paying off the past due payments over the 3 to 5-year Chapter 13 plan. Because this stops the interest and collection costs from continuing to accrue on that past due balance, the Chapter 13 gives you a real chance of catching up.

Lien Stripping

One of the most interesting tools in a Chapter 13 is something called "lien stripping". This tool allows us to completely remove and eliminate a wholly unsecured 2nd loan. Here's what that means. Let's say you own a house worth \$250,000. You have a 1st mortgage with a balance of \$260,000 and a 2nd mortgage (or home equity line of credit) for \$50,000. We can argue that the 2nd mortgage is not really a "secured debt" because the house isn't worth enough (anymore) to secure both the 1st and 2nd mortgages. So, we "strip" the 2nd mortgage and classify it as an unsecured debt in your Chapter 13 plan along with your credit cards, medical bills, and other unsecured debt. That class of debt will likely be paid very little, if anything, in your Chapter 13 plan. Just like that, we wiped out your 2nd mortgage.

Rescheduling Secured Debts & “Cramming Down” the Interest Rate

The payment terms on secured debts (other than for your primary residence) can sometimes be extended through the length of the Chapter 13 plan and the interest rate changed to reflect something closer to the “prime rate”. For example, if you have 3 years left on a car loan, you could potentially restructure that car loan to extend the payments out for the full length of a 5-year Chapter 13 plan, thus lowering the payments. At the same time, you can reduce the interest rate down to something much more reasonable, which will also reduce the payments. Win-win!

Qualifying for Chapter 13

Not everyone qualifies for a Chapter 13. To be eligible to file a Chapter 13 you cannot have more than \$394,725 in unsecured debts or \$1,184,200 in secured debts. (These amounts are adjusted periodically). That may sound like a lot, but one major hospitalization can easily add up to hundreds of thousands in unsecured debt. Tax debt is another big one that pushes people over this limit. If you were self-employed or operating an unincorporated business, those debts may count as well.

There also rules related to prior filings that may disqualify you. If you’ve ever filed bankruptcy before (no matter how it ended) check with an experienced bankruptcy attorney before doing anything.

Credit Counseling Requirement

Before you can file for bankruptcy you must take a credit counseling class. It will give you tips on how to balance your budget going forward. It is normally an hour long and can be taken online. At the end of the course, you will be given a certificate that must be filed with the court.

Filing the Chapter 13 Petition and Plan

If you decide to file a Chapter 13, you and your attorney will prepare a petition for bankruptcy and a proposed Chapter 13 payment plan. To do this, your attorney will need to review your assets, income, budget, debts, bank statements, and tax returns (at a minimum). Once this review is complete, your attorney will prepare and review with you a packet of papers called the Petition and Schedules. Your attorney will also

develop a payment plan to propose to the Court. After reviewing these with you, your attorney will file these papers with the bankruptcy court. These papers list information about you, your debts and creditors (both secured and unsecured), your real and personal property, and income and expenditures. You must list all your debts and all your assets.

The Automatic Stay

The moment the Petition is filed, the “automatic stay” becomes effective. This stops (stays) most collection actions against you or your property during the pendency of your case. There are exceptions for certain types of debts (child support, for example) that can be collected while your case is pending.

Chapter 13 Trustee and Meeting of Creditors

After your Petition is filed, the bankruptcy court will send a notice to all your creditors, other interested parties, and you. This notice will identify the trustee assigned to your case and the date on which the meeting of creditors (also called the 341 meeting) will be held. The meeting of creditors is usually held approximately 20 to 40 days after the bankruptcy petition is filed. At this meeting, the trustee will ask you a series of questions, which you must answer under oath, about the information contained in your petition, your assets, debts and additional information that may be related to your case. Your creditors are entitled to appear and also ask you questions, but they rarely do unless it’s a personal debt, such as to a former spouse, business partner.

Chapter 13 Plan Payments

Your first Chapter 13 plan payment is due 30 days after your petition is filed, even if you haven’t had your 341 Meeting of Creditors. This 30-day period starts when the petition for bankruptcy is filed. So, if you are filing an “emergency petition” where you just file the petition and later file the schedules and proposed plan, keep in mind that you will still owe your first plan payment after those first 30 days. Your plan payment is made to your Chapter 13 Trustee – not to your attorney. After your case is filed, you will receive information from the Trustee’s office about where to send your payment or how to pay

online. Your attorney can also ask the Trustee to take the payments right from your paycheck so that you don't have to worry about it.

Payments on Secured Debt

Generally, you will still need to independently make the payments on any secured debt you intend on keeping (e.g., your car or house). This will be your usual payment and will be separate from any plan payment. In Maryland, we don't often do "conduit payments" where you give your mortgage payment, for example, to the Trustee who then sends it to the mortgage company. So, remember that you are still responsible for making those payments. Be sure to discuss this with your attorney before you file so that there is no confusion.

Chapter 13 Discharge

In most cases, once you have completed your Chapter 13 plan payments (usually 3 to 5 years), you will receive a discharge. This means that all eligible debts and any balances on debts that were partially paid in your plan are wiped out. Before you receive a discharge, you must take a debtor education course from an approved provider and file proof with the court. The filing of the discharge does not close the case. A case may remain open after discharge for a short or long period of time depending on the facts. However, the discharge order releases you (and your spouse if a joint filing) from personal liability for most debts.

Conclusion

Chapter 13 Bankruptcy can be a lengthy and complicated process, but it is very powerful. If you intend to file, you should consult an attorney first to ensure you are making the right decision, you qualify for the relief requested, and you understand what assets can and can't be protected.

If you are properly prepared and informed, Chapter 13 bankruptcy can provide genuine relief from your financial problems. Make sure you are well-prepared so that you can have a smooth bankruptcy and receive that fresh start that is the goal of every debtor who files Chapter 13 bankruptcy.