BANKRUPTCY: COMPLETE RELIEF FOR THE HONEST DEBTOR

My clients are always sorry to meet me. By the time we're sitting across from each other around a conference table they've had trouble sleeping, eating, getting along with their spouse and smiling at their kids. It's awful having to call a bankruptcy lawyer. But for many people, meeting me is the first step towards doing one of the best things they've done in their lives: file bankruptcy and get a fresh start.

Discharge in bankruptcy is the legal term for the debtor's fresh start (a debtor is someone who owes money). After filling out the forms, telling your story to the trustee and waiting for another sixty days, the odds are good that the Bankruptcy Court will issue you a *Discharge Order*, freeing you of most debts. This is a remarkable and extraordinary benefit not to be taken for granted. Breaking free of staggering credit card claims, medical bills, business lawsuits and other dischargeable debts clears the debtor from a tremendous burden. But not every debt gets discharged and not everyone gets a fresh start after filing bankruptcy.

What are the Consequences for the Dishonest Debtor?

Almost every bankruptcy judge will tell you that discharge is only for honest debtors, and judges take that very seriously. It should come as no surprise to most people that lying on bankruptcy papers can cause a debtor to lose their property, forfeit their discharge and, in extreme cases, be criminally prosecuted. These papers are being signed under penalty of perjury, and the bankruptcy world takes that oath VERY seriously.

What many people don't know is that in addition to lying, *reckless disregard for truth* will also cause a debtor to lose a discharge. More and more bankruptcy judges are finding that debtors who display a careless lack of attention to the facts and circumstances of their finances also don't deserve a discharge. What are the kind of lies or mistakes or omissions that may cause you to lose that fresh start you and your family desperately need? Here are 10 reasons you might not be free of your debts after filing for bankruptcy.

1. Omitting property. This is the most important error people make filling out their schedules. Failing to list bank accounts, boats, real estate, jewelry and other valuable assets will almost automatically deprive you of receiving a discharge.
2. Omitting transfers. Many people are afraid when they feel themselves sliding into bankruptcy. They don't want to have the bankruptcy trustee strip them of their valuable assets. When that happens, people transfer cars, homes, stocks and bonds and other assets to people they know and trust to hold for them. These people frequently hope that they can then file bankruptcy and not get caught. Usually, this results in disaster. When a debtor transfers property within a year before the bankruptcy case, with the intent to keep that property out of the hands of creditors, that debtor will not get a discharge in that case.
3. Omitting payments to family members. Many people know that sometimes the trustee can sue creditors who receive payments during the 90 days before bankruptcy. What they don't know is that the

trustee can sue insiders who receive payments during *the year before bankruptcy*. Insiders can include business partners, family members and the business entities the debtor owns. Most people want to make sure that their family members who loaned them money are repaid. When they find out that the trustee can sue their family member for payments made within the year, they simply omit this information from the bankruptcy papers, or else they leave out the fact that they owe the money at all. When a trustee discovers that these payments have not been disclosed in the bankruptcy schedules, he will likely seek to have that debtor's discharge denied, or forfeited.

4. Omitting creditors. Many people want to pick and choose the assets and the debts they will include "in their bankruptcy". However, the bankruptcy system does not work that way. Debtors have virtually no discretion about the information that goes into their bankruptcy schedules. They are required to list:

   a. All assets, at their fair market value
   b. All debts, including debts to family members
   c. All contracts they have with other people or companies, and all leases
   d. All debts owed with someone else, such as a spouse, a child, a business partner or a wholly owned company
   e. All income, from whatever source, whether claimed or paid "under the table"

f. All expenses, for whatever purpose.

The papers that the debtors have to fill out are called the "Schedules". The schedules of income and expense are very important, and a severe understatement of income or overstatement of expenses would also be grounds for denying a discharge.

5. Even disclosed transfers may cause a debtor to lose a discharge. Any transfer made within a year before the bankruptcy for the purpose of hindering, delaying or defrauding creditors will cause a debtor to lose the right to a discharge. In many states, that would include transferring valuable property to your spouse or to yourself and your spouse jointly if that transfer would remove the asset from the reach of your creditors. People often think that disclosure of this transfer will cure the perceived fraud, but that's not true.

6. Omitting a business. In addition to the Schedules of Assets and Liabilities, there is an important document called the "Statement of Financial Affairs", or SOFA for short. The SOFA requires debtors to disclose:

   a. Their income for the last two years
   b. Payments made to creditors during the 90 days or 1 year before the bankruptcy case
   c. Whether any property has been repossessed by a creditor, or voluntarily returned to a creditor
   d. Whether there has been any losses from fire, theft, other casualty or gambling, and whether the losses were covered by insurance

e. If the debtor has been the party to a lawsuit prior to bankruptcy, and the details of that suit

f. If the debtor owns a safety deposit box, and the contents of the box

g. If the debtor closed any bank accounts or sold any stock before the bankruptcy

h. How much the debtor paid their lawyer before the bankruptcy was filed

i. Details about any business that the debtor owned more than 5%, was an officer, director or manager during the six years before the bankruptcy.

The debtor's intentional failure to list any of these items could cause the debtor to lose their discharge. Many debtors get caught off guard by the requirement to disclose their businesses. They believe that because the business is closed or has no assets they don't have to list the business. *This is a terrible mistake*. Debtors are frequently reminded that they cannot change the plain terms of the Schedules and SOFA, which specifically require disclosure of ALL assets, debts, income and expenses, not just those assets, debts, income and expenses that the debtor wants to disclose.

7. Failing to keep records may also cause a debtor to lose the right to a discharge. It is common for people in financial trouble to have been sued and have judgments against them. When that happens, people learn painfully that judgment creditors have the right to seize their bank accounts. To protect against this loss, some debtors keep all

their income in cash and pay all their bills in cash. There is nothing illegal about this. However, if the debtors are then unable to prove to the trustee or the bankruptcy judge how much cash was received and where that cash was spent, the judge may decide that the debtor is hiding assets. If that happens, the debtor will not receive a discharge. This is a sad result, when the debtor could simply have given and received receipts for receiving and spending their cash.

8. Destroying records so that the trustee cannot understand your financial condition will also cause the court to deny you a discharge. It is no surprise that people who are afraid to lose assets or for the world to learn that the assets were improperly spent will not want others to discover the existence of the assets. Many tales are told of floods, or fires, or thefts, or other supposed disasters that cause a debtor to be unable to present documentation of their finances. Unless supported by substantial corroborating evidence, these stories are often viewed skeptically, and if disproved will result in the debtor being denied the discharge.

9. Failing to cooperate with the trustee can be another basis for denial of a discharge. Sometimes trustees need to obtain a court order to compel the debtor to turnover property or business records, or to attend another examination under oath. If the debtor continues to resist the trustee even after the bankruptcy judge has required cooperation, the debtor will almost certainly be refused a discharge.

10. In addition to signing their bankruptcy schedules and SOFA under penalty of perjury, debtors are also required at least once to be examined by the trustee under oath. This examination is often one last chance for the debtor to purge a prior misstatement and to explain to the trustee the true state of their assets and income. However, if the debtor makes a knowingly false statement under oath they will likely not be discharged of their debts.

Frequently, a debtor can cure mistakes and omissions in their schedules by filing amendments with the court. Amending something that's wrong is usually a good idea, even though it will suggest that the debtor didn't pay careful enough attention to the bankruptcy schedules in the first place. However, amending schedules after someone has already exposed the omission doesn't usually do much good. In these situations, the debtors are said to have been caught "with their hand in the cookie jar" and the correction in the schedules gives little comfort to the bankruptcy judge that the debtor has been completely honest with all of their required disclosures. Once a debtor is caught in an untruth or important omission, the fragile trust that supports the entire bankruptcy system is gone. Courts and trustees fear that if a debtor is lying about one part of their schedules, they may very well be lying about the rest.

How Does the Dishonest Debtor get Caught?

1. Online Public Records

The access to information has truly exploded since almost every home and business now has access to always-on high-bandwidth internet services. Almost every state

has tried to keep pace with this explosion by allowing internet visitors free or very inexpensive access to a host of online public records. These records include:

a. Land records, such as recorded deeds, mortgages and releases;

b. Court records, such as filed complaints and other civil lawsuits, divorces, small claims matters, foreclosures and criminal matters;

c. Business records, such as articles of incorporation, dissolution, corporate good standing and resident agent;

d. Financing statement records showing those lenders who have liens against their borrowers, and the specific items of property subject to the liens;

e. Records of property sales, ownership details, payment of property taxes and other property information.

Creditors also frequently have access to borrowers' social security numbers. Armed with this powerful information, the debtors' credit reports may become available, opening the debtors up to even more exposure about their lives.

With so much information available to creditors, debtors simply can't afford to misstate the facts about their finances. Even basic investigation of online records may disclose whether the debtor has listed all of their lawsuits, their creditors and their real estate. Public records available through the motor vehicles' department will verify whether the debtor owns a vehicle, and what creditor holds a lien in that vehicle. Many debtors fail to disclose their businesses that have closed down or have

no value, but a public search will almost always reveal the existence of this business, thereby casting a shadow over every part of the debtor's credibility.

2. An enemy

Bankruptcy debtors are often seeking protection from a creditor who has sued and won. These creditors may have a host of inside information about the debtor from that litigation, or else may be:

a. A former spouse

b. A former business partner

c. A former friend

If any of these people have hard feelings from their dealings with the debtor, getting that discharge can become very difficult. A debtor may not list their silver tea set, their baseball card collection, etc., and a trustee may have no way of knowing about these assets without an angry insider whispering in their ear. For this reason it pays to be especially careful when filling out bankruptcy schedules and the SOFA when a creditor is also an enemy.

3. US Trustee Audit

The Office of the United States Trustee is a division of the US Department of Justice assigned to oversee *every bankruptcy case*. The US Trustee conducts random audits of bankruptcy debtors to ensure the overall integrity of the bankruptcy process. As an agent of the federal government, the US Trustee has access to a host of information not generally available such as tax records and boat and aircraft registries. A US Trustee audit may also involve a home visit. There are few things more uncomfortable than being present when an officer of the US Trustee inspects

your home and finds silver, artwork and electronics that were not disclosed in the Schedules. If the US Trustee turns up a significant asset that may very well bar the debtor from receiving a discharge.

4. An Aggressive Creditor

Many creditors *are* willing to throw good money after bad to collect a debt, even once the debtor has filed for bankruptcy. Creditors can take depositions of the debtor, seek disclosure of bank records and other documents, and can investigate the debtor's comings and goings. Like an enemy, an aggressive creditor can probe deeply into the debtor's finances and cause tremendous discomfort for the debtor who has not fully disclosed their assets and income.

5. Carelessness

Many debtors tend to forget that their lives are well documented. Insurance policies frequently contain jewelry riders and a trustee may ask to see that policy. If there is such a rider but no jewelry is disclosed on the Schedules, that debtor will have a problem. Similarly, a debtor's bank statement may indicate receipt of a significant gift or inheritance that was not disclosed in the Schedules. Copies of the front and back of canceled checks may show the existence of undisclosed creditors who received otherwise hidden payments the trustee may seek to recover. It has been said that people who tell the truth don't need to have a very good memory, and nowhere is that more true than in the bankruptcy arena.

What Does the Creditor Have to do to Deny the Debtor's Discharge?

Objections to discharge can only be presented by way of filing a complaint with the bankruptcy court. These lawsuits are known in the bankruptcy world as

adversary proceedings. The section of the United States Bankruptcy Code governing complaints objecting to discharge is section 727(a), which contains a number of requirements that only honest debtors will receive a discharge:

(a) The court shall grant the debtor a discharge, *unless*—

(2) the debtor, *with intent to hinder, delay, or defraud* a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—

> (A) property of the debtor, within one year before the date of the filing of the petition; or
>
> (B) property of the estate, after the date of the filing of the petition;

(3) *the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information*, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case;

(4) the debtor *knowingly and fraudulently*, in or in connection with the case—

> (A) made a *false oath or account*;
>
> (B) presented or used a *false claim*;
>
> (C) gave, offered, received, or attempted to obtain money, property, or advantage, or a promise of money, property, or advantage, for acting or forbearing to act; or
>
> (D) *withheld from an officer of the estate entitled to possession under this title, any recorded information*, including books, documents, records, and papers, relating to the debtor's property or financial affairs;

(5) the debtor has *failed to explain satisfactorily*, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities;

(6) the debtor *has refused*, in the case—

> (A) *to obey any lawful order of the court, other than an order to respond to a material question or to testify;*
>
> (B) on the ground of privilege against self-incrimination, to respond to a material question approved by the court or to testify, after the debtor has been granted immunity with respect to the matter concerning which such privilege was invoked; or
>
> (C) on a ground other than the properly invoked privilege against self-incrimination, to respond to a material question approved by the court or to testify;

Even though the consequences for dishonesty are severe, the debtor does not have long to wait before finding out if there is a challenge to the discharge: complaints objecting to discharge must be filed within 60 days after the first date set for the meeting of creditors. This is a very short timeframe and is *strictly construed*, so creditors who file their complaints on the 61st day after the meeting of creditors will find their complaint dismissed.

The first date set for the meeting of creditors is usually 30-40 days after the bankruptcy case is filed. The "first date set" language is important: debtors sometimes seek, and receive, postponements of the trustee meeting. The 60 day window for filing complaints objecting to discharge opens on the first date set for the meeting, not the actual meeting date. For this reason, trustees will almost always require the debtors to agree to an extension of time to file these discharge complaints in exchange for the trustee's consent to a postponement of the meeting. Trustees know that the threat that the debtor will not receive a discharge is the best tool for ensuring the debtor's complete cooperation during the bankruptcy case.

Sometimes debtors will not provide the trustee with all the information that the trustee has requested, and the 60 day window will soon close. In these

situations, the trustee may file a motion to extend the time to object to the debtor's discharge. The trustee need only file the motion before the 60 day period lapses, and need only show that there is cause for the extension. This is a very light standard and such motions are almost always granted.

If a creditor, the trustee or the US Trustee does file a discharge complaint, the court will conduct a trial without a jury. The judge will hear all the testimony and review all the documents and decide whether the debtor will receive a discharge. The plaintiff in this lawsuit need only prove that it is more likely than not that the debtor did one of the things required by Section 727 to deny the debtor a discharge. Trials on discharge complaints are nerve wracking affairs for every debtor.

Complaints objecting to a debtor's discharge are extremely serious matters and so are very difficult to settle, even if both the debtor and the creditor would like to strike a deal. Under the Bankruptcy Rules a discharge complaint cannot be dismissed unless there is notice to the trustee and the US Trustee and approval by the bankruptcy judge. This is so because if a debtor is truly not entitled to a discharge the bankruptcy system does not want the debtor to enjoy that benefit simply by paying off one creditor.

Can the Debtor fix the Problem by Filing Another Bankruptcy Case?

Debtors have only one chance to discharge a debt in bankruptcy, and there is no opportunity for the repentant debtor to get a second bite at the apple by filing another bankruptcy case after being denied a discharge in the first. Section 523(a)(10) of the Bankruptcy Code specifically denies the dischargeability of any debt "that was or could have been listed or scheduled by the debtor in a prior case

concerning the debtor … in which the debtor waived discharge, or was denied a discharge." This means that if a debtor does not get a discharge in bankruptcy in one case, those debts that were scheduled or *that could have been scheduled* will be with that debtor forever. This penalty is a strong incentive to get the bankruptcy case right the first time.

Discharge in bankruptcy is a remarkable benefit, but one not to be taken for granted, and only honest debtors who fully expose their finances to the review of the trustee and creditors will receive that discharge.