

3 QUESTIONS EVERY BANKRUPTCY

Lawyer MUST Ask Before Filing A Case



The Three Questions Every Bankruptcy Lawyer MUST Ask Before Filing A Case

By Ronald J. Drescher

Learning substantive law is easy for most lawyers. We have years of school under our belts followed by a career spent reading cases, statutes and rules. Now, with COVID-19 crippling America's economy, many lawyers hope to capture part of the expected surge in bankruptcies from this unprecedented economic shutdown.

We welcome you! I believe that the coming tsunami of bankruptcy cases will overrun the existing system of lawyers, trustees and judges. Why?

Here is a list of major companies who have closed/furloughed employees:

Tesla
Under Armour
JCPenney
The Wing
ClassPass
Boeing
Sotheby's
Sephora
Macy's
Bird
Everlane
ZipRecruiter
Sonder
GE
Air Canada
Cirque du Soleil
New York Metropolitan Opera
Pebblebrook Hotel Trust
Marriott International
Norwegian Airlines

Scandanavian Airlines
Hilton Hotels
Nieman Marcus
Nordstrom
Belks
United Air Lines
American Air Lines
Yelp
Gap
Kohl's
Hobby Lobby
Disney

The list goes on and on and on. And these companies only scratch the surface.

By the time our world reopens in a meaningful way, in YOUR community, every restaurant, bar, hair salon, fitness center, movie theater, sports arena and countless other small businesses will have closed for at least a month, likely two months or more.

The COVID-19 economic crisis couldn't have come at a worse time.

The widely cited Report on the Economic Well-Being of U.S. Households in 2018 published by the Board of Governors of the Federal Reserve System painted a bleak picture of Americans' ability to cover relatively minor unexpected expenses:

- If faced with an unexpected expense of \$400, 61 percent of adults say they would cover it with cash, savings, or a credit card paid off at the next statement. 27 percent would borrow or sell something to pay for the expense; 12 percent would not be able to cover the expense at all.
- Seventeen percent of adults are not able to pay all of their current month's bills in full. Another 12 percent of adults would be unable to pay their current month's bills if they also had an unexpected \$400 expense that they had to pay.
- One-fifth of adults had major, unexpected medical bills to pay in the prior year. One-fourth of adults skipped necessary medical care in 2018 because they were unable to afford the cost.

This bleak report was issued when unemployment was at a fifty year low. Now, following the economic devastation of the COVID-19 virus, the prospects for American families are beyond imagination. According to Fortune Magazine, as of April 16, 2020, the unemployment rate was an astounding 18% and rising.

Let's take a closer look at the US economy and the efforts by Congress to address the devastation wrought by the coronavirus. According to investopedia.com the US GDP is \$22.32 trillion. Salon Magazine estimates the total cost of the coronavirus between \$5 and \$7 trillion, which would be almost a third of the US annual revenue stream.

Federal, state and local authorities are doing their best to provide relief to consumers. Many jurisdictions have imposed foreclosure, eviction and debt collection forbearance, but these efforts must end sometime. When these bills come due, either tenants/homeowners/debtors will suffer the pain of repaying these missed months or landlords/mortgagees creditors will suffer the pain of permanently foregoing these payments. Even if the government throws \$3 trillion at the problem, trillions of dollars will be lost. The US mint can't print money fast enough to compensate for this horrible loss.

This devastation came at a frightening tipping point for US consumers. According to Motley Fool, American consumers ended 2019 with a total of \$4.2 trillion in debt not related to housing—much of which can be attributed to credit cards. Even worse, in the 4th quarter of 2019, before Americans had even a hint of the COVID nightmare to come, the delinquency rate on credit cards had risen to 5.32 percent, the highest rate since the 2008 economic meltdown had begun to decline in 2011.

So the handwriting is on the wall: US bankruptcies are about to skyrocket, and, following a decade of declining bankruptcy filings, the system is not prepared for the onslaught of cases.

I've been asked to help lawyers transition their practices to include a bankruptcy component. In response, I've created this PRAGMATIC GUIDE to help lawyers make the move to become bankruptcy counsel. I've identified three critical questions every bankruptcy lawyer must answer before filing a bankruptcy case.

Question One: When to file?

You've been interviewed and hired by prospective client. You've learned your cloud-based bankruptcy software. Are you ready to file the case?

Maybe not.

A host of timing considerations play a part in determining when to pull the trigger before filing your client's bankruptcy. Reading the Bankruptcy Code from cover to cover may not give you enough practical guidance in some of these timing considerations:

- **Discharge of income taxes**

- The general rule is that a debt is discharged from the debtors personal liability unless it falls into a specific subsection of section 523(a) of the bankruptcy code. Most people don't know that income taxes are dischargeable in bankruptcy people don't know that income taxes are dischargeable in bankruptcy

- Timing considerations:

- 3 years after returns first become due (watch out for extensions!)
- 2 years after return actually filed (some jurisdictions require returns to have been filed on time)
- 240 days after assessment (most relevant for audits and tax court appeals)

11 USC Section 523(a)(1), 507(a)(8).

- Nontiming considerations

- No effort to evade taxes
- No fraud

- Watch out for substitute returns: may NEVER be dischargeable

- Payroll & sales tax obligations: never dischargeable, always priority

Practical considerations: unless the client formally requested an extension of time to file their tax returns, generally taxes for the year ending December 31 three years prior become dischargeable on April 15 of the fourth year. Thus taxes

for the year ending December 31, 2016 became dischargeable on April 15, 2020. You will need to obtain a transcript to be sure that the client did not obtain an extension of time, and DID file their returns two years before the proposed bankruptcy date.

So if you have a client who has taxes due for the year 2017 you may choose to put off the filing until after April 15, 2021 (or, if on extension, after October 15, 2021). This may raise considerations of option weighing: if the taxing authority is demanding a payment plan or if the client is being garnished by another creditor a dollar value analysis needs to be made whether it pays to wait to get out from under a debt that will become dischargeable after the passage of time.

- Income considerations to enable filing of Chapter 7 for high income clients
 - Fluctuation in income: key indicator is last full six months

This consideration is especially important when the client has received a significant year end bonus or has fluctuating income, like many real estate professionals who rely upon settlements for their income. Sometimes it pays to wait until a high earning month passes out of that 6 full month window; alternatively, it may pay to hurry up the filing if the client is enjoying a particularly prosperous month that you do not want to include in the six-month look back. This may very well make the difference between allowing the client to obtain the complete relief available in chapter 7 or obligate them to make the stream of payments required under chapter 13.

- Protection of pre-bankruptcy transfers
 - Payment of creditors
 - Payment of family
 - Transfer of assets for protection purposes

The trustee can avoid and recover transfers debtors made during the 90 days before bankruptcy. Frequently, especially if a debt is being paid that is guaranteed by a friend or family member, the debtor will want to pay that debt and ensure that the trustee cannot recover it, thereby prejudicing the friend or family member.

On the other hand if the client has repaid a family member on account of an existing debt the waiting period is one year. I have frequently convinced clients to wait that length of time in order to protect the family member from a lawsuit by the trustee.

Finally, some clients simply have too much equity in a significant asset to make filing worthwhile, even under chapter 13. In those situations the client may have no other choice but to convey the property to a trusted family member and wait the three years (or more depending upon your state jurisdiction) for the fraudulent conveyance limitations period to expire.

- Eligibility for repeat filers
 - 2/4/6/8 rule

in order to answer this question, you just apply the simple rule of 2-4-6-8. Here is how it works.

2 years - If you previously filed a Chapter 13 case where you received a discharge, then you can file a second Chapter 13 case after 2 years and receive a discharge.

4 years - If you previously filed a Chapter 7 case and received a discharge, then after 4 years you can file a Chapter 13 case.

6 years - If you previously filed a Chapter 13 case and received a discharge, then after 6 years you can file a Chapter 7 case.

8 years - If you previously filed a Chapter 7 case, then after 8 years you can file another Chapter 7 case.

- Recovery of garnishments
 - Transfers in 60 days must exceed \$600

Although the power to recover preferential transfers typically resides solely in the trustee, if a transfer is involuntary, like a wage garnishment, the debtor may recover those transfers provided they are exempted by the debtor and the trustee does not seek to recover them. However, such transfers must exceed \$600 over the prior 90 day period. You may want to advise the client to either wait to file until the garnishment exceeds \$600 in the aggregate or accelerate the filing to maximize

this recovery, which could bring thousands of dollars back into a client's purse (and become a source of payment for the attorney).

- Avoidance of transfers
 - May want to set aside a transfer, e.g. financing statement

I had a case where a bonding company for a failed construction firm did not record a financing statement until well after the company ceased operations. We filed a bankruptcy case within the 90 days after the recording of the financing statement in order to free millions of dollars of assets for the benefit of creditors. Careful attention to pre-bankruptcy transfers is critical to afford the client the best available relief.

- Prevention of Judgments for possession
 - Automatic stay does not apply when judgment for possession entered

 - Limited exception to this rule ALMOST IMPOSSIBLE TO SATISFY

If a landlord of residential property obtained a judgment for possession prebankruptcy, the automatic stay of bankruptcy does not apply to the landlord's efforts to evict the client and obtain possession of the premises. The landlord may continue to evict as if the tenant had never filed bankruptcy.

There is an exception: a debtor can enjoy the protection of the automatic stay when the debtor (1) pays into the Bankruptcy Court one month's rent upon the filing of the bankruptcy case AND (2) provides for a cure of all prior rent delinquency during the first 30 days after the bankruptcy filing. This is such an onerous provision that in 30 years I have never seen a client able to satisfy these terms. Section 362 (l).

Some readers may wonder why "What Chapter?" is not the first question. The reasons are both substantive and practical. If the client

comes to see you on the second to last day of the month, but your analysis shows that the filing needs to be done THAT MONTH, you only have one day to get the

case filed. That analysis needs to be done before you decide which chapter (you can typically convert from one chapter to another).

Question Two: Where to File?

If you've done the work or spent the money to generate a good bankruptcy lead, it can be frustrating to learn that the client doesn't qualify to file a bankruptcy case in jurisdictions where YOU practice. This is why it's critically important to learn as soon as possible where venue will be appropriate.

America is a multistate social and economic culture. Clients regularly travel or relocate either permanently or temporarily, for many reasons. Under the venue rules the debtor needs to have spent at least 91 of the prior 180 days before filing in one of the following four jurisdictions:

- Residence - where you live
- Domicile - where you intend to live permanently
- Principal place of assets - self explanatory, could include business ownership
- Principal place of business - generally does not count where you work as salaried employee

In practice, if a client has any significant assets in a state the client will likely be able to file in that jurisdiction.

Question Three: What Chapter?

Finally, the question you've all been waiting for! In general, chapter 7 is the preferred remedy for most clients.

Chapter 7

This chapter provides the most relief in the shortest time. The typical no asset chapter 7 case lasts for less than 100 days. When the case begins, the debtor is saddled with crippling debt. When the case ends, the debtor enjoys a fresh start, leaving behind credit card and personal loan debt, debts arising from evictions and car repossessions, medical debt and older taxes. However, sometimes chapter 7 is simply not available; in that case you'll need to file a chapter 13 case for the client.

Chapter 13

Chapter 13 is a powerful, though frequently rigid, procedure where the debtor will make a payment to a trustee over a term of 36 to 60 months. I have identified nine reasons why a debtor may need to file a chapter 13

case:

1. Client makes too much income (means test)
2. Client has too much equity in assets
3. Client has obtained chapter 7 discharge in case filed within last 8 years
4. Client has debt that cannot be discharged in Chapter 7:
 - a. tolls/parking tickets/other motor vehicle fines
 - b. Marital property awards (not domestic support obligations)
 - c. Less common: intentional property damage
5. Strip off valueless liens on real property
6. Restructure car loans
7. Client behind on mortgage/car loan
8. Temporary respite from enforcement on student loans
9. Taxing authorities won't agree to payment plan

I created a YouTube playlist Why Chapter 13 at <https://bit.ly/whych13> that presents the top seven reasons why your client may need to file Chapter 13.

Chapter 11

While I expect the number of Chapter 11 cases to rise dramatically, a discussion of Chapter 11 is well beyond the scope of this article. Chapter 11 is a highly complex, litigation-driven procedure that is best suited for businesses or individuals with sophisticated finances.

The primary reason a consumer would consider a Chapter 11 filing is that they own a home with a secured claim above the Chapter 13 debt limits (as of April 22, 2020 the limits are unsecured debts of less than \$419,275 and secured debts of less than \$1,257,850).

Final Thoughts

Many of the lawyers I talk to hope that they can inch into a bankruptcy practice by limiting their cases to easy Chapter 7s. Fill out a few forms, collect a fee, appear at the trustee meeting and you're done. Easy money! But if you don't pay attention to the complex timing, venue and other bankruptcy laws you could find yourself having a very uneasy feeling when the trustee asks your client a question that you weren't prepared for.

I don't want that to happen to you.

The bankruptcy system will need competent practitioners to manage the crush of cases to come, and I want you to be as prepared as possible.

Ronald J. Drescher has been practicing bankruptcy law since 1985, even BEFORE he graduated law school. He is licensed to practice and has filed thousands of bankruptcy cases in California, Maryland, Delaware, Virginia and Pennsylvania. His YouTube channel has 250 videos related to bankruptcy practice. He has written dozens of articles on bankruptcy and created infographics such as The Baseball Bankruptcy Hall of Fame, The Bankruptcy Jukebox, The Bankruptcy Bighouse, The Bankruptcy Red Carpet, The Bankruptcy Tailgate Party, The Masters: A Bankruptcy Unlike Any Other, The Panama Canal: A Bankruptcy Between The Seas, The Real Housewives Of Bankruptcy and many others. He has also authored two books, *File Bankruptcy And Get Rich* and *The Single Mom's Guide To Financial Recovery*. These books have over 2,000 copies in circulation.

Finally, and most importantly to Ronald, he has over 150 five star reviews on Avvo.com and Google, more 5 star reviews than any other bankruptcy lawyer in Maryland.