Legal Basics: Bankruptcy Protections for Older Consumers

NATIONAL CENTER ON LAW & ELDER RIGHTS

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The National Consumer Law Center

The National Consumer Law Center uses its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults and people of color. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, federal and state government and courts across the nation to stop exploitive practices, and help financially stressed families build and retain wealth, and advance economic fairness.

Key Lessons

1. Bankruptcy may be the easiest and fastest way for older consumers to deal with all types of debt problems.
2. Bankruptcy temporarily stops almost all creditors from taking any steps against the elder except through the bankruptcy process.
3. Bankruptcy can permanently wipe out the legal obligation to pay back many debts.
4. Bankruptcy allows older consumers to keep many types of assets including certain retirement plans and pensions.

An increasing number of older consumers are struggling with unmanageable debt. Debt collectors are using aggressive tactics to pursue older adults with limited resources, making it critically important for legal services attorneys to understand protections that may help their clients. Bankruptcy may help older consumers eliminate debt and preserve income needed to pay rent, buy food, and keep the lights on.

Section 1: What is Bankruptcy?

Bankruptcy is a process under federal law designed to help people and businesses get protection from their creditors. Federal law provides a right to file for bankruptcy[1] and bankruptcy cases are conducted in federal bankruptcy court.[2]

In the short term, bankruptcy prevents continued efforts by creditors to collect debts. In the long term, bankruptcy can completely eliminate repayment obligations on certain debts enabling consumers to get a fresh financial start.

Bankruptcy is often considered a "last resort" for financially troubled consumers. In some cases, however a delay in filing for bankruptcy can result in a loss of legal rights especially if the process is needed to stop a foreclosure sale or repossession of a car. (For example, bankruptcy cannot help the consumer to keep a home after it has been sold at a foreclosure sale.)

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1 11 USC §§ 101-1532.
2 11 USC § 105.

Glossary

Automatic stay	With a few exceptions, the automatic stay stops creditors from taking debt collection action once the consumer files the necessary paperwork to begin a bankruptcy case.
Bankruptcy	The legal proceeding designed to help people and businesses get protection from creditors.
Collection proof	A consumer is collection proof if all of her assets and income are protected by law from a creditor trying to collect on a debt or enforce a court judgement.
Discharge	Elimination of the legal obligation to pay a debt.
Exempt	Property that cannot be sold that the debtor gets to keep in a chapter 7 or chapter 13 bankruptcy.
Liquidation	A process associated with a chapter 7 bankruptcy where the court's appointed trustee examines the debtor's asset and determines whether anything is available to be sold for the benefit of creditors.
Reorganization	A process associated with a chapter 13 bankruptcy where the debtor submits a plan to repay her debts.
Secured creditors	A creditor that has taken a mortgage or other lien on a property as collateral for a loan.

Section 2: How Can Bankruptcy Help Older Consumers?

Bankruptcy can be the right choice if the older consumer does not have a better way to deal with debts. It may make it possible for the elder to eliminate the legal obligation to pay debts such as medical debt and debt from long term care or nursing home facilities. This benefit comes from the bankruptcy "discharge" that a consumer gets for successfully completing a bankruptcy case.

Bankruptcy can stop debt collection harassment, wage garnishment, and similar creditor actions to collect a debt and stop almost all creditors from taking any steps against the older consumer except through the bankruptcy process. This is provided by the "automatic stay" that goes into effect as soon as the consumer files the necessary paperwork at the beginning of a bankruptcy case. Foreclosures, tax sales, repossessions, utility shut-offs, lawsuits, and other creditor actions will be immediately (but perhaps only temporarily) stopped.

Section 3: Two Common Types of Bankruptcy Filings for Older Consumers

The bankruptcy law provides for two main types of consumer cases which elders can use: chapter 7 and chapter 13.

Chapter 7 Bankruptcy: Liquidation

A case under chapter 7 of the bankruptcy law is often called a "liquidation." In a liquidation case, the consumer's—referred to as the debtor—assets are examined by a court appointed trustee to determine if anything is available to be sold for the benefit of creditors. Property that cannot be sold and that the debtor gets to keep is called "exempt." The trustee may sell only property that is either not exempt or has value exceeding the exemption limits. In most cases, all of the consumer's property is exempt, including most retirement funds.[3]

At the end of a chapter 7 case, the debtor obtains a discharge of most unsecured debts. This means that the debtor will no longer have a legal obligation to pay those debts. Generally, the discharge will include credit card debts, medical bills, utility arrearages, and other similar debts for which the creditor does not have collateral. Some unsecured debts, such as most student loans, debts arising from fraud or malicious conduct, drunk driving debts, most tax debts, government fines, alimony, and child support are not likely to be discharged.

Chapter 7 bankruptcies rarely help with large secured debts, such as home mortgages. This is because the creditor keeps its rights to the collateral (the home). Thus, a chapter 7 case will not affect, except temporarily, the rights of a bank to foreclose on a home or repossess a car that is collateral for the loan. However, if an elder debtor received a chapter 7 discharge and a creditor later sells its collateral (i.e., the car), then the creditor may not sue the debtor for any balance still owed.

Chapter 13 Bankruptcy: Reorganization

A case under chapter 13 of the bankruptcy laws is often called a "reorganization." Unlike chapter 7, in a chapter 13 case, the debtor submits a plan to repay her debts—such as mortgage or car loan—some or all of what she owes the creditor over time, usually from future income.

Chapter 13 cases also allow debtors to keep both exempt property, which would be protected in chapter 7, and non-exempt property, which would be sold in chapter 7. The elder can keep the property by paying its non-exempt value to creditors under a court approved plan.

The heart of a chapter 13 case is the bankruptcy plan. This is a document outlining how the debtor proposes to make payments to various creditors while the plan is in effect.

A chapter 13 bankruptcy plan normally requires monthly payments to the bankruptcy trustee over a period of three years. However, plans can last for as long as five years with court approval. Once payments are completed under the plan, the debtor is entitled to a discharge. The discharge available in chapter 13 covers more debts than a discharge under chapter 7. If the debtor has caught up on any mortgage debt or other secured loan, the loan will be reinstated and the law requires the creditor to treat the debtor as if she never fell behind. For example, some older consumers use a chapter 13 plan to catch up on property tax payments to avoid a foreclosure on a reverse mortgage.[4]

Section 4: Is Bankruptcy the Right Option?

Bankruptcy cannot cure every financial problem. Nor is it the right step for every individual. In bankruptcy, it is usually not possible to eliminate certain rights of "secured" creditors. A creditor is "secured" if it has taken a mortgage or other lien on property as collateral for a loan. Consumers can force secured creditors to take payments over time in the bankruptcy process and bankruptcy can eliminate an obligation to pay any additional money on the debt if the consumer decides to give back the property. But a consumer generally cannot keep secured property unless she continues to pay the debt.

Bankruptcy allows the debtor to keep certain assets. The elder is allowed to exempt or keep certain retirement funds. This includes common types of pension, profit-sharing, and stock bonus plans; employee annuities; individual retirement accounts (including Roth IRAs); deferred compensation plans of state, local government, and tax-exempt organizations; and certain trusts.

Bankruptcy generally does not protect cosigners on debts. When a relative or friend has co-signed a loan, and the consumer discharges the loan in bankruptcy, the cosigner may still have to repay all or part of the loan.

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3 11 USC § 522 (d).

4 Chapter 13 Plan, Official Form 113: uscourts.gov/sites/default/files/b_113_and_cn_0.pdf

Bankruptcy cannot discharge several types of debts singled out by the bankruptcy law for special treatment, such as child support, alimony, most student loans, court restitution orders, criminal fines, and most taxes. Bankruptcy also cannot discharge debts that arise after bankruptcy has been filed. Because of this, older consumers may wish to delay a bankruptcy filing until they are reasonably sure that they will not incur new major debts.

Section 5: Alternatives to Bankruptcy

Older consumers with debt problems often want to file bankruptcy primarily to stop collection harassment. While this can be a good reason for seeking bankruptcy protection, there may be other ways to stop the harassment or to ease the senior's fears about the collection process. For some, simply becoming aware that that they are "collection proof" may reduce their stress and desire to file bankruptcy. A consumer is "collection proof" if all of her assets and income are protected by law from a creditor trying to collect on a debt or enforce a court judgment.

Other elders take comfort in knowing that they can take steps to stop the collection calls. The simplest way to stop collection harassment is to write the debt collector a cease letter.[5] Federal law requires collection agencies to stop their collection efforts after they receive a written request to stop.

Conclusion

Most consumers file bankruptcy only as a last resort after carefully considering other alternatives. Those who are struggling to keep up with unmanageable debt should weigh these alternatives in relation to the hardships that may be avoided by obtaining bankruptcy relief. In some cases, bankruptcy may be the only realistic alternative to eliminate debt and preserve income and property that an older consumer may need to maintain a healthy and safe lifestyle.

Additional Resources

- Consumer Financial Protection Bureau: consumerfinance.gov
- Federal Trade Commission: ftc.gov
- Legal Assistance
  - » National Association of Consumer Advocates: consumeradvocates.org
  - » Legal services/Legal aid: lsc.gov/what-legal-aid/find-legal-aid
  - » Volunteer lawyers: americanbar.org/groups/legal_services/flh-home/flh-free-legal-help.html
- Advocacy Organizations
  - » National Consumer Law Center: nclc.org
  - » National Association of Consumer Bankruptcy Attorneys: nacba.org
- Publications
  - » National Consumer Law Center, Consumer Bankruptcy Law and Practice (2009 ed.)
  - » National Consumer Law Center, Guide to Surviving Debt (2010 ed).
  - » NCLC's Consumer Concerns for Older Americans, Credit Card Debt and Credit Counseling.

5 See §2.3.2. National Consumer Law Center, Fair Debt Collection (8^{th} ed. 2014).

» NCLC's Consumer Concerns for Older Americans, Dealing with Debt Collection Harassment.

» NCLC's Consumer Information on Bankruptcy, Your Legal Rights During and After Bankruptcy.

» NCLC's Consumer Information on Bankruptcy, Using Credit Wisely After Bankruptcy.

Case consultation assistance is available for attorneys and professionals seeking more information to help older adults. Contact NCLER at ConsultNCLER@acl.hhs.gov.

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