

HOW TO MAKE THE TRUSTEE HAPPY AND KEEP YOUR CLIENT OUT OF TROUBLE

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Preliminary concerns

Is filing a bankruptcy the best choice for the client?

I occasionally see clients who have one very large unsecured claim (typically on a business debt), or clients who have non-exempt assets which they would lose in bankruptcy, or clients who have several small debts owed to payday lenders, or clients who owe a large amount of stale debt. In many of these cases, bankruptcy may not be the best option because the clients may be able to solve their problems without filing.

In the case where the debtor owes one large unsecured debt, we often prepare a case for filing and send it to the creditor with a settlement offer. (The amount of the offer is generally based upon the value of non-exempt assets.) If the creditor accepts the offer, my client may take a small hit to their credit as the debt will reflect “paid, settled” on their credit report, but that is better than a bankruptcy.

I occasionally see clients who have four or five credit cards totaling \$50,000, but they also have \$20,000 in an investment account. They can spend that money in an appropriate manner, they can file Chapter 7 and turn it over to the trustee, or they can try to settle with their creditors. Many credit card companies and debt buyers are taking steep discounts on credit card debt, so if the client has some cash, this may be an option. (As a practice point, tell the clients to get it in writing that the creditor will accept this amount of money in full satisfaction of the debt and report it as “paid, settled” on their credit report. Also as a practice point, the clients should not tell the creditor they have \$20,000 in cash and \$50,000 in debt, because this creditor does not care about the client’s other problems and will want to be paid in full. The clients should tell the creditor that they “can come up with” the money if the creditor will settle.)

Remember that there may be tax consequences of settling debt. Debt forgiveness is generally treated as ordinary income in the year that the debt is forgiven, unless the debtor is insolvent. In that situation, there will typically be no real tax consequences. See IRC Section 108(c) and Form 982.

With the payday lenders, I typically “suggest” to my clients that they tape the collection calls. The payday lenders are particularly prone to violate both the federal Fair Debt Collection Practices Act and the Texas Debt Collection Act, which is also a per se violation of the Texas Deceptive Trade Practices - Consumer Protection Act. (I would note that the Attorney General of Texas issued an advisory opinion some years ago that says it is unethical for an attorney to “advise” a client to tape phone calls, even though it is absolutely legal in Texas. Because of that opinion, we do not “advise” clients to tape collection calls, we simply tell them that a tape would be the best proof of what was actually said.) We typically settle these debts for a release of the claim and if the conduct is egregious enough, we demand (and get) some compensation.

It is actually fairly common for me to see clients who have several debts on which limitations have run, but they came to see me because one of the lenders (or its assignee) has now sued on their debt. If limitations has run, we can easily defend the collection action. (Their credit report will list the date of last payment which is typically all you need to prove limitations. After all, this is the information

the creditor is publishing to the world.) Some of these clients still want to file to “clean up my credit,” but you need to explain to them that stale debt will drop off their report after seven years, but the bankruptcy will stay on for ten years. If all of their bad debt will drop off in the next year or two, it may not be worth filing.

Who is going to file?

This includes the obvious eligibility issues:

- * The dollar limits for Chapter 13 contained in Section 109(e).
- * The inability to obtain a discharge under Section 727(a)(8) in a Chapter 7 case commenced within 8 years of the commencement of a prior Chapter 7 case.
- * The inability to obtain a discharge under Section 1328(f)(1) in a Chapter 13 case if the debtor received a discharge in a Chapter 7 case within 4 years prior to commencement of the Chapter 13 case.

There are also the practical concerns involving who needs relief. I routinely see couples who are absolutely convinced that they both have to file because they are married or because Texas is a community property state. Our homework package asks the client to list their debts and to indicate who owes the debt (husband, wife, or joint). I routinely have clients who list all of their credit card debt as joint “because we are married.” I had a couple who listed 16 credit cards totaling \$104,000 and indicated that all of them were joint. I questioned them about that. They insisted. I looked at their credit reports and the wife had one credit card with a \$3,000 balance. The husband had 15 credit cards totaling \$101,000. If he can discharge his debt, they can pay hers and she preserves her credit. That way, if they need to buy a car next year, she can get a decent interest rate.

In Texas, home equity loans must be non-recourse so if the deficiency after a foreclosure of an equity loan is the concern, neither spouse needs to file.

It is not really common, but we sometimes see clients where one spouse might have (how shall we say this?).....”misbehaved” and might not be able to obtain a discharge under Section 727 or might face an exception to discharge under Section 523(a). For that client, filing bankruptcy might provide no relief and the client might end up with a finding of fraud which could follow them for years to come. Some of these clients will decide they have nothing to lose so they will want to file and “take a shot.” As a practitioner, be incredibly careful if you decide to accept this representation. Explain the risks and likely outcomes in detail in writing. If you think the debtor is likely to lose, say so clearly. There are cases where you should absolutely refuse to decline the representation. (How does the debtor come across? Credibility is a huge issue in 523 and 727 litigation. If I don’t like the guy, I know Judge Davis isn’t going to like the guy.)

Which chapter provides the client with the relief they need?

My clients tend to fall into discrete, easily identifiable categories. The person with a large amount of unsecured (typically credit card) debt. The person with a large amount of tax debt and the IRS is

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