

My name is Ken Ayotte, and I'm a Professor of Law at the UC Berkeley School of Law. I'm here today to give you a brief introduction to personal bankruptcy, but first a brief disclaimer. This introduction is just intended to provide some helpful background information, but don't take it as legal advice. For guidance on your specific situation, it's a good idea to consult with a bankruptcy attorney in your state. The goal of personal bankruptcy is to provide honest but unlucky individuals a fresh start, allowing them to keep some of their assets and their future income free from the claims of their pre-bankruptcy creditors. The fresh start is part of American law for a reason. It encourages risk-taking because it softens the landing for those who take legitimate risks, like starting a business, and then fall on hard times. It also provides, as the Supreme Court put it, a clear field for future effort. People don't tend to be as productive as they could be when they're weighed down by excessive debt, so bankruptcy has a role to play in improving productivity.

The two most common chapters for personal bankruptcy are Chapter Seven and Chapter 13. But before giving an overview of those chapters, let's introduce a few terms that will be helpful and apply in all bankruptcies. So first, the automatic stay. When a bankruptcy petition is filed, all collection activity-- foreclosures, judgments, garnishments-- must come to a temporary stop. And this gives the debtor some breathing space to sort out his or her affairs. Second, discharge-- a discharge is a release from personal liability on debt. And that's really the goal of personal bankruptcy, to get a discharge of as much of your pre-bankruptcy debt as possible. Third, secured an unsecured debt-- secured debt is a loan that's backed by some kind of collateral. We might say that a secured creditor has a lien on an asset you own to guarantee payment on the debt. So mortgages, home equity loans, and lines of credit, most car loans, are secured loans. Unsecured debt is debt for which there is no collateral, just a personal obligation to repay. Credit cards, medical bills tend to be unsecured. Bankruptcy does a lot more work for debtors on unsecured debt than secured debt. The general rule is that liens survive bankruptcy even though your personal liability is discharged. It would be great if you could file for bankruptcy, get rid of the mortgage, and keep the house. But unfortunately, it doesn't work quite that well.

Secured creditors notwithstanding bankruptcy have the right to be paid the amount of their secured claims. If they're not, they can still take their collateral. They just can't come after you personally for any deficiency if you received a discharge. OK, dischargeable and non-dischargeable debts-- some debts can be discharged in bankruptcy, but some, by law, cannot. Student loans, taxes, child support obligations, these debts are typically unsecured but not dischargeable. Most other debts, however, are dischargeable. Finally, exemptions-- the bankruptcy code allows for debtors to keep some assets outside the reach of unsecured creditors. These exemptions vary by state and typically include some personal necessities, retirement accounts, and some amount of equity in the debtor's home and car.

Let's talk about Chapter Seven versus Chapter 13. Chapter Seven is liquidation bankruptcy. In a Chapter Seven case, nonexempt assets are turned over to a trustee, and those assets are sold to repay creditors. Sometimes, this is nothing at all. In fact, the majority of Chapter Seven cases are no asset cases in which the debtor receives a discharge despite not leaving any assets for unsecured creditors. Chapter Seven provides a more complete fresh start. If you get a discharge in Chapter

Seven, all of your future income is yours free from the claims of those discharged debts. Chapter 13, on the other hand, is a repayment plan. You keep your assets, but you pay your disposable income to a trustee for a three to five year period depending on your circumstances. Chapter 13 gives you the opportunity to cure defaults. That means if you're behind on your payments on a house, a car, or some other asset that's important to you, you can make up the missed payments to your creditors during the life of the Chapter 13 plan and keep your asset. Your discharge, though, is postponed until you complete the plan.

So who should file for bankruptcy? And who should choose Chapter Seven? Who should choose Chapter 13? Well, empirical studies suggest that it would take a typical debtor over 15 months of income if all of that income was used to pay off only unsecured debt, and over three years of income if all of that income was used to pay all pre-bankruptcy debts. And what that tells me is that people tend to file for bankruptcy when they're so heavily indebted that they don't see a path to paying their debts on their own.

So what about Chapter Seven or Chapter 13? Well, about 70% of personal bankruptcy filings are Chapter Seven, and that makes some sense. Chapter Seven, as we discussed, is a lot faster and easier than Chapter 13. You can get your discharge in Chapter Seven in a matter of only a few months. Chapter Seven is a particularly good choice if you have very little valuable assets to turn over anyway. So if Chapter Seven sounds so good, who would file for Chapter 13? Well, there are two main reasons. One, as we discussed, if you have some important assets like a house or a car with defaults that you want to cure, and you think you have the means to do it with your future income, you just need time. Second, you may have no choice. You may have heard that Congress changed our bankruptcy laws in 2005. And one of the most important changes is that more debtors are being channeled into Chapter 13. If you're above median income in your state and you demonstrate some ability to pay your unsecured creditors, you may be ineligible for Chapter Seven. There is an important downside to Chapter 13 that I should share with you. Most Chapter 13 plans, as much as 2/3 in some studies, fail before the debtor receives a discharge.

All right, let's talk about the process and some requirements. Bankruptcy is not particularly easy or particularly cheap. You'll probably want to hire an attorney. It is legally permissible to file for bankruptcy without a lawyer, but very few debtors do so, and with good reason. Bankruptcy is complicated. Many requirements for documentation when you file, and there are many important choices that can act as traps if you're not sophisticated, and if you don't have good advice. You will need to produce a lot of information on your assets, your liabilities, your expenses. You'll need to produce tax returns and pay stubs, for example. You'll also need to complete a credit counseling course before filing and a debtor education course after filing to get your discharge. There are online options for these courses, and they tend not to be too expensive.

So how much does bankruptcy cost altogether? Well, it depends a lot. It depends on where you live. It depends on the chapter you're filing. But the total cost of bankruptcy is typically over \$1,000 and can be several thousand dollars. It's not cheap, particularly for those in financial distress. But remember that the amount of debt you can discharge in bankruptcy can be many times the amount you'll pay in fees and court costs. You'll have to attend what's called a 341 Meeting of Creditors. You might be imagining some scary encounter where you're sitting on a witness stand, the judge is banging his gavel, and angry creditors are grilling you. But that's not the way it works. Usually, a 341 meeting is just a brief meeting

with the trustee. You'll have to answer some simple questions under oath about your bankruptcy documents. Creditors can show up, but they usually don't. Here are some useful resources if you'd like additional information about bankruptcy. uscourts.gov is a good website for forms and an overview of the various chapters. You can find some useful information there. Bankruptcyresources.org, from the American Bankruptcy Institute, has some helpful Q&A and links to some important resources such as the ability to find lawyers and places to find pro bono representation in your state if you have difficulty paying the costs of bankruptcy.

As a final note, remember I said earlier the goal of the law is to provide a fresh start to individuals who appear honest but unlucky. And what that means is if you do things that look dishonest or shady, the law has mechanisms in place to deny your fresh start. Here are some examples-- selling assets to a friend or family member before filing with the hopes of getting them back later on. Running up credit cards and taking a vacation before you file for bankruptcy. Hiding assets or failing to disclose debts. That kind of advantage seeking can hurt you, so best not to try it. There are legitimate and legal pre-bankruptcy planning strategies you can use, and a good lawyer can tell you more about what you can and can't do before filing. About a million people file for bankruptcy each year. It is a legitimate legal tool available to those who are financially distressed and can't repay their debts. Thanks for watching, and I hope this brief introduction to bankruptcy has been useful to you.