

HOW THE AUTOMATIC STAY PROTECTS YOU FROM COLLECTION ACTIVITIES DURING BANKRUPTCY

What Is It?

When you file for bankruptcy, a very powerful federal law called the automatic stay immediately takes effect. The automatic stay stops collection efforts and makes it illegal for creditors to attempt to collect a debt. It applies in both Chapter 7 and Chapter 13 bankruptcies.

The automatic stay provides you with some breathing room to get organized and figure out your next steps. In Chapter 13, the automatic stay also protects co-debtors who are liable with you on consumer related debts.

What actions does the stay prohibit creditors from taking?

The stay prohibits creditors from:

- Beginning or continuing lawsuits related to your property or debt.
- Making collection calls or sending letters.
- Repossessing your personal property.
- Foreclosing on or selling your real estate.
- Garnishing or levying on your wages or bank accounts.

It is against the federal law for creditors to violate the stay. A creditor that violates the stay will face penalties. Furthermore, a creditor's actions in violation of the stay are generally void or voidable. This means they have no legal effect and can be treated like they never occurred or court action can be used to reverse their effect. For example, if a person files for bankruptcy and the creditor receives notice, but then continues to garnish the individual's bank account, he or she will be entitled to the sum garnished and the

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creditor might face other sanctions imposed by the bankruptcy court.

What activities can continue despite the automatic stay?

The automatic stay has some limitations. Specifically, the automatic stay does not apply to:

- Criminal proceedings and active investigations against you.
- Claims or lawsuits that arise after you file bankruptcy unless they are related to credit or property in your bankruptcy estate (generally all property you own on the date you file, less exemptions).
- Actions for family support orders (i.e. child support or spousal support) or the modification of such orders
- Actions to collect support from property that is not property of the bankruptcy estate (nonexempt property that cannot be protected by your claimed exemptions)
- Tax audits, demand for tax returns or assessment of tax; however, the collection of such taxes is stayed.
- The start of foreclosure proceedings by HUD.
- Creation of statutory liens for real estate taxes that arose after your filing date.

In addition to the above limitations, there are two actual exceptions for when the automatic stay does not apply. These limitations only apply for “repeat” or “serial” bankruptcy filers. The automatic stay goes into effect for only 30 days after you file bankruptcy if you have previously filed bankruptcy and your case was dismissed in the past year. The automatic stay does not go into effect at all if you have filed bankruptcy and had two or more previous cases dismissed within the past year.

These special exceptions do not apply if it has been more than a year since any prior bankruptcy case or proceedings were dismissed or closed. These one-year exceptions also do not apply if the following three factors are true: (1) you initially file for relief under Chapter 7; (2) the court rules that your income is too high and you do not qualify under the “means test” for Chapter 7 bankruptcy; and (3) you refile under Chapter 13.

When does the automatic stay begin?

The automatic stay takes effect the moment a bankruptcy is filed. No action besides the actual filing of the bankruptcy petition is required to trigger the automatic stay.

When does the automatic stay end?

The automatic stay is not permanent. With most debts, the automatic stay lasts while the case is pending and ends at discharge or dismissal of the case. When you receive a bankruptcy discharge (this is the goal of bankruptcy), your obligation to pay most debts ends. So, in effect, the debts your creditors were stopped

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from collecting by the automatic stay become permanently “stayed” by the discharge. The exception is if you want to keep property securing a loan, you must continue to make payments. However, as long as you don’t reaffirm the debt (sign a new contract), if you stop making payments on a car or house loan, you will not owe for the deficiency because of your prior bankruptcy discharge. However, the creditor can still repossess or foreclose on the property.

If your case is dismissed (i.e. thrown out) by the court for any reason, the automatic stay immediately stops as of the date of the dismissal. At this time, creditors have all their rights reinstated and can pursue collection, garnishment, foreclosure, repossession, and other rights that may be afforded the creditor under state or federal laws.

Will the automatic stay stop an eviction?

If you are behind on your rent when you file, but your landlord has not yet obtained a judgment of possession (eviction notice) from the court, the automatic stay will prevent your landlord from evicting you, unless the landlord files a motion and persuades the bankruptcy court to lift the stay (see below). However, the landlord can evict you for past due rent that accrues after you file, in spite of the automatic stay.

If you file for bankruptcy after your landlord has obtained a judgment against you for possession of the rented property, the eviction judgment usually allows the landlord to continue with the eviction process. A few states have laws that allow you to stop the eviction with a bankruptcy filing for a brief time and get caught up on your rent. The time allowed is not usually more than 30 days and there may be other requirements (e.g. you may be required to deposit the delinquent amounts with the bankruptcy court clerk within 30 days after the bankruptcy filing). In these states, the automatic stay will apply for the 30 days and the landlord is then free to continue the eviction.

How does the automatic stay help with foreclosure situations?

The automatic stay can be an effective planning tool to assist in foreclosure situations. Although foreclosure proceedings vary from state to state, in most situations there is a firm date by which the foreclosure will become permanent unless the homeowner brings the arrears current. The automatic stay, if the case is filed before the actual foreclosure date (or sheriff’s sale), will actually stop or delay a sheriff sale or foreclosure sale date at least temporarily. The benefits and relief depend, in part, on whether you file for bankruptcy under Chapter 7 or Chapter 13.

Chapter 7: In Chapter 7, the automatic stay can provide you with the ability to temporarily stop a sheriff’s or foreclosure sale. This might allow you to save some cash to use for living expenses (e.g., moving costs and rent) if the foreclosure eventually goes through, or buy you some time to get caught up on the arrearage. The relief of the automatic stay in Chapter 7 lasts for a short time only, but it still can be an effective tool in

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providing some time and a temporary hold on the foreclosure. Eventually, if the arrearage cannot be brought current, you may still face foreclosure, but the time the automatic stay is in effect allows you time to plan.

Chapter 13: In Chapter 13, the automatic stay can give you valuable time to restructure other debts and keep your property from being foreclosed. Chapter 13 bankruptcy allows you to set up a repayment plan to pay off the past due mortgage payments. You can further propose the length of time for repayment (with a maximum of 60 months) to bring the arrearage current *and* maintain your current mortgage payments simultaneously. So long as you make the required payments, both regular mortgage payments and arrearage payments through the Chapter 13 plan, and the plan is confirmed by the bankruptcy court, the automatic stay will remain in effect and you will avoid foreclosure.

Additionally, Chapter 13 (and the protection of the automatic stay) can eliminate second and third mortgages on a property that is underwater. Chapter 13, but not Chapter 7, entitles homeowners to recategorize underwater second and third mortgages as unsecured debt. The actual process of how this occurs varies greatly from state to state and usually the homeowner has to obtain a full discharge and complete the entire Chapter 13 plan to complete the conversion of the underwater mortgages to unsecured debt.

Can the automatic stay end before the bankruptcy is concluded?

A creditor can bring a motion in bankruptcy court to “lift the stay” for the debt owed to that creditor before the case is completed. In most cases when this occurs, a secured creditor wants the stay lifted to foreclose on real estate or to repossess a car after the debtor has fallen into arrears.

Common examples include creditors seeking to foreclose on property in which the debtor has no equity and that is not insured. During bankruptcy proceedings, when the equity is negative or small (i.e. the amount owed is almost as much as or more than the value of the property), you may have to make “adequate protection payments” to the creditor to show good faith and preserve the equity cushion to allow the automatic stay to remain in effect. This most often comes into play between a Chapter 13 filing date and the time the plan is confirmed.

When a creditor files a motion for relief from the stay, the matter is set for a hearing in front of the bankruptcy court. You must be given an opportunity to oppose the motion. To give you and your attorney time to prepare, the hearing is usually scheduled out a few weeks. If you do not oppose the motion (which is often the case with bankruptcy filers), the court will automatically grant the creditor’s motion to lift the stay. If you oppose the motion, the court may make a ruling at the initial hearing or will set it for a second, more detailed hearing to make a final decision.

If the court lifts the stay, the creditor is free to pursue its state law rights (e.g. foreclosure or repossession).

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The stay is not lifted just because the creditor files a motion. The creditor must first bring the motion *and* be granted relief before the creditor can engage in any further collection activity. Whether the court will lift the stay depends on the facts.

In Chapter 7, motions to lift the stay are usually brought quickly after the filing date and rulings are also made quickly. This is because the timelines in Chapter 7 are so much shorter than in Chapter 13. However, in a Chapter 13 case, creditors can bring motions to lift the stay at any time while the case lasts, which can often run 60 months.

Motions to lift the stay in Chapter 13 most often occur when the filer fails to keep up with required payments during the repayment plan period. The Chapter 13 plan process requires you to stay current on your actual plan payments to the trustee and also on your secured debt (e.g. mortgage, car loan, etc.) Sometimes secured debts are paid through the plan and the trustee disburses payments to the secured creditors and sometimes the filer continues to make secured payments directly to the creditor in addition to a Chapter 13 plan payment.

Whether the secured creditor is paid through the plan or outside of the plan, if you fall behind in any payments and the secured creditor is receiving no funds to apply to the secured collateral, the creditor will file a motion to lift the stay. By filing the motion for relief from the automatic stay the creditor is telling the bankruptcy court that it is not receiving money under the terms of the Chapter 13 plan. To avoid motions to lift the stay in Chapter 13, stay current on all plan payments and secured debt payments, and keep insurance coverage on homes and vehicles. The original contract with the creditor requires that insurance coverage be maintained.

What happens if a creditor violates the automatic stay?

The automatic stay is a court order. If a creditor violates the automatic stay, it can be liable for actual damages caused by the violation and in some cases even punitive damages. However, damages above what you actually lost are rare and apply in the most egregious cases only. If the automatic stay is violated, it is best to immediately inform your attorney, notify the bankruptcy court, and even notify the creditor of your bankruptcy. Even though creditors receive notice of the bankruptcy filing, often the creditor is actually unaware of your case filing through its own error or negligence. Sadly, this is not that uncommon. If the creditor continues to violate the automatic stay, you can file a lawsuit seeking damages from the creditor.