Appeals Court Ruling May Affect Bankruptcy Laws

August 31, 2010 - When Congress modified the bankruptcy law nearly five years ago, one of the key elements of the new law was that anyone wishing to file for bankruptcy needs to seek credit counseling. Until recently, that requirement has been interpreted to mean that anyone not having already attended counseling couldn't file for bankruptcy. If they did, their suit could immediately be dismissed or the judge could simply strike the bankruptcy petition altogether. Now a ruling from a three judge panel of the US 2nd Circuit Court of Appeals has reviewed the law. Their interpretation of it is completely different, and could give those filing for bankruptcy additional protection from creditors.

(function() {
var s = document.createElement('SCRIPT'), s1 = document.getElementsByTagName('SCRIPT')[0];
s.type = 'text/javascript';
s.src = 'http://widgets.digg.com/buttons.js';
s1.parentNode.insertBefore(s, s1);
})();

The case is known as Adams v. Zarnel and it stems from a motion by the US Trustee to dismiss the bankruptcy case of Shayna H. Zarnel and two other co-petitioners. The motion to dismiss was requested because the petitioners had not gone through credit counseling prior to filing.

Instead of dismissing the case however, the judge hearing the case decided to strike the case of each petitioner. Once the case is stricken, it is as if they never filed for bankruptcy in the first place. This created problems for both the bankruptcy petitioners and for the US Trustee's office.

The problem for the petitioners occurred because as soon as they filed for bankruptcy, they had protection from their creditors. After anyone files for bankruptcy, creditors can no longer contact them directly or attempt to collect on debts. All contacts need to be made through the court. As soon as the judge struck the case, these protections went away.

The problem for the US Trustee's office and for the government arises from the fact that if a bankruptcy case is dismissed and then filed again within a year, the stay limiting contact from debt collectors is limited to 30 days. If two cases have been dismissed within a year, there is no stay issued to debt collectors. By striking the case, the judge was allowing the petitioners to file for bankruptcy a second time but still receive the benefit of an immediate stay against debt collection activity.

The 2nd Circuit ruling in the appeal significantly changes the law. It said that the judge was wrong for striking the case because the stay against debt collection activities had already been put in place. But then the court went one step further. It essentially ruled that the provision of the laws requiring credit counseling could be fulfilled after filing for bankruptcy; not just before the filing. And it left the discretion to make this determination in the hands of the judge hearing the case.

The ruling is not just academic. Often, when people file for bankruptcy they are within days of losing their homes, cars or businesses. The ruling means that even last minute filers may be able to stop collection and foreclosure activities without having to fulfill the credit counseling requirement first. Again, this is apparently up to the discretion of the judge hearing the case so it would be advisable that anyone who can comply with the credit counseling requirement ahead of time should take that option. But the ruling does give hope to those who have waited until the last minute.

Although the ruling is only binding in the 2nd Circuit, it is likely to be looked at by other US Courts of Appeal in similar cases.

byJim Malmberg

Note: When posting a comment, please sign-in first if you want a response. If you are not registered, click here. Registration is easy and free.

Follow me on Twitter: