Reaffirming debts in bankruptcy.

Bankruptcy (generally) allows a debtor to eliminate his personal responsibility for a debt. This is why most people file for bankruptcy. Reaffirming a debt is making a new agreement to pay the debt in spite of the bankruptcy. It is giving up the right a debtor has to eliminate the personal liability with respect to the debt.

Why would someone reaffirm a debt?

Good question. Well, it is usually done, sometimes mistakenly, in order to retain the property that the debt is secured by. (I say mistakenly because usually, or almost always, the debtor would be able to keep the property anyway—more on that in future posts.) Contrary to what you may think, typically a debtor is the one who wants to reaffirm, and their lawyer is advising them not to. The debtor is usually not as objective, and has some personal or emotional desire to retain the property (house, car, etc.) that is not held by the lawyer.

Why not just let the debtor do what they want?

The societal benefit to bankruptcy is to allow a debtor a "fresh start" by freeing them of their debts to become a more profitable, more beneficial economic unit. It also relieves much of the debtor's stress that comes from a heavy debt load. Reaffirmation cuts against the purpose or benefit to society, and is why the decision to reaffirm is, in a sense, regulated, if you will. 11 U.S.C. § 524(c).

If a party is without counsel, they must attend a hearing and have the court approve the proposed agreement. If a party is with counsel, the attorney is asked to declare that the agreement:

1) Represents a fully informed and voluntary agreement by the debtor;
2) Does not impose an undue hardship . . .
3) He fully advised the debtor of the legal effect and consequences of –
    A) [the agreement]
    B) Any default under [the] agreement.

Sometimes an attorney refuses to make the certification. Sometimes a presumption arises that the debtor cannot afford to pay the debt when he completes the forms. In these cases, then there will likely be a court hearing, even if a party is represented by counsel. And the court could have a hearing on the matter even without these circumstances.

With or without counsel, there are certain forms that must be used and there are disclosures the debtor must have received. In Massachusetts, there are local procedural rules that apply too. MLBR 4008-1.

Overall, it is a major decision that should be carefully thought through. We will write more about the other options a debtor has with respect to the treatment of secured debts in bankruptcy, such as surrender, redemption, and the so-called “4th option” in later posts.

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