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COST OF LIVING

Bankruptcy as a Step to Solvency

By M. P. DUNLEAVEY

THE idea of declaring bankruptcy may be unpleasant, even abhorrent, but for many people right now it could be the best option.

The question is: How do you make that choice? How bad do things need to get before you throw in the towel, and most of your debts, and petition the courts for a fresh start?

More than a million people filed for [personal bankruptcy](#) in the 12 months that ended last September, a staggering 30 percent increase over the period a year earlier, according to the Administrative Office of the U.S. Courts. And thousands more “are unofficially bankrupt” and reluctant to file, said Justin Harelik, a lawyer with Price Law Group in Los Angeles.

“I’m aware that the word itself carries so much shame and stigma,” said Mr. Harelik. “But it’s right for so many people.”

The sting of failure and the dread of ruined credit are, understandably, deterrents to a bankruptcy filing. But those fears can prevent people from taking advantage of the financial protection offered by bankruptcy, which may allow you to erase most of your consumer debt while preserving assets like your retirement accounts and sometimes even your home and car. Instead, many people delay filing until they are truly desperate.

“When we surveyed people about how long they seriously struggled, over 40 percent said more than two years,” said Katherine M. Porter, associate professor at the [University of Iowa](#) law school and a researcher with the Consumer Bankruptcy Project, a continuing study of consumer bankruptcy filings. “A lot of attorneys say they wish people would come earlier, before they emptied their retirement accounts or lost their car to repossession,” she said.

Because bankruptcy is so complex, and because bankruptcy laws underwent a major overhaul in 2005, many people are not only wary of filing, but also confused about their options and what the possible outcomes are.

One common misunderstanding is that declaring bankruptcy will ruin your credit. If you’re at the point of even considering bankruptcy, it’s likely that your credit is in tatters anyway, notes Ms. Porter.

“You may not end up that much worse off,” she said. In some cases, your credit could emerge in better shape once you’ve dealt with your debts.

Another myth is that you must be at the frayed end of your financial rope before you file. You won't lose everything in a bankruptcy because some assets are protected, and you will need those to move forward, says Elizabeth Warren, a professor at [Harvard](#) Law School and one of the lead researchers on the Consumer Bankruptcy Project. Waiting until your resources are entirely depleted defeats an important purpose of bankruptcy, "which is to help people rebuild their lives on a sounder footing," Ms. Warren said.

It was the desire to move forward with her life, not just shrug off her debts, that finally pushed Claire Morgan, who lives in Chicago, to begin the bankruptcy process in December. In addition to lingering [student loans](#) of about \$12,000, Ms. Morgan had been struggling to pay \$40,000 in credit card debt — a sum slightly higher than her annual income, she said. But she couldn't make any headway.

In part, it was the sense of futility that finally pushed Ms. Morgan over the edge. But she also happened to hear a cautionary tale about a friend, also deeply in debt, who had decided not to declare bankruptcy — and ended up living in constant strain, unable to move forward with life.

"That really made me think twice," she said. "Bankruptcy was the last thing I wanted. But it's better to be able to say 'I'm in the clear' than to be still be struggling in five years to pay \$40,000 in debt on a \$35,000 salary."

Knowing whether to file, when to file and whether to do so under Chapter 7 or Chapter 13 of the bankruptcy code is a decision best made with the help of a lawyer. Most bankruptcy lawyers offer a free initial consultation, Ms. Porter said. The National Association of Consumer Bankruptcy Attorneys has a Web site where you can search for a lawyer by location.

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