

What Is The Bankruptcy Co-Debtor Stay?

by Adrian Lapas, Eastern North Carolina Bankruptcy Attorney on January 24, 2010

Once you file a bankruptcy case, the automatic stay serves to prohibit creditors from taking any action against you. What if one of the accounts which is included in your bankruptcy is co-signed by someone else? You, as the debtor, are protected by the automatic stay. What about the other person?

Suppose you have a joint credit card or a co-signed car loan with a parent or an adult child? Understandably, a potential debtor would be very concerned about filing bankruptcy if it would lead to adverse consequences against the co-debtor. Is the creditor going to “tee up” this person? The answer can be found in Section 1301 of the U.S. Bankruptcy Code.

If the co-signed debt is a “consumer” debt, meaning that it was incurred by an individual primarily for a personal, family or household purpose, and you filed under chapter 13 of the Bankruptcy Code, the creditor may be prohibited from taking any action to collect a co-signed debt. The purpose of this provision is to prevent creditors from bringing indirect pressure on debtors by taking collection actions against the non-bankruptcy filing co-debtors upon the filing of a bankruptcy petition.

But limiting the effect of the co-debtor stay to ‘consumer’ debt is a very important limitation. Very often, people will personally guarantee loans made for business purposes. If that is the case, the co-debtor stay would not be applicable.

Additionally, the co-debtor stay merely serves to delay the creditor from receiving the benefit of its bargain of obtaining another person to be jointly liable on the debt. If a chapter 13 plan does not propose to pay the obligation in full, the creditor may ask the court for permission to pursue the co-debtor (called a Motion for Relief from the Co-Debtor Stay).

Finally, the co-debtor stay does not serve to protect the non-filing co-debtor from the effects of any pre-bankruptcy filing delinquencies with regards to credit reporting. If a debt is delinquent, it may be reported to the credit reporting agencies as delinquent.

The debt may not be reported as being in bankruptcy for the non-filing obligor because that person did not file bankruptcy. Often, creditors will report an account as being in bankruptcy for both the debtor who filed bankruptcy and for the non-filing debtor. The account should not be reported as being in bankruptcy for the non-bankruptcy filing debtor and this situation can usually be fixed with a letter to the credit reporting agencies.