

A Good Lawyer: Another Person's Bankruptcy

The tightening by banks on lending money has caused people to go elsewhere — possibly to you. It may start with you hearing about the opportunity to “make money” (on the interest, of course) by providing a loan to a person you think of as a friend — or at least someone you trust, or a company that you think will be able to pay you back (with that interest). Then, time goes by, and you do NOT get paid back. What are your rights? A good lawyer asks that question BEFORE you lend the money.

The first question to ask is, “What are my rights if the person (the debtor) files for bankruptcy?” Other questions should include whether: the interest charged is usurious (illegal); the money will be invested or loaned to purchase real estate; it is for start-up capital in a new or existing business; or it is just a personal loan.

There is no substitute for thorough due diligence on the potential debtor, which is why a good lawyer will conduct title, background, and judgment searches. Would you lend money to someone who has a million dollars in judgments? Or more in mortgages than their real estate is worth?

Whatever the case, prior to lending money, your lawyer should advise you about the consequences of bankruptcy by the debtor because that might be the proverbial “worst case scenario.”

In a bankruptcy, if you are an “unsecured creditor,” meaning that you do not possess or have not secured a lien on any of the debtor's assets as collateral for your loan, it is likely that you will not recover a single penny. A good lawyer knows that.

And if you don't have a lien on real estate, then bankruptcy may quite possibly exempt all other assets from collection, especially

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if the debtor has spent or sold most else by the time of the bankruptcy filing — also not uncommon.

Therefore, your objective should be to eliminate, or at least mitigate risk by obtaining security for your loan, especially a lien on debtor's real estate. Accordingly, you want to be a “secured creditor” rather than an unsecured creditor. How can you become “secured?” Here are the best ways:

1. Agreement. Always start with a loan and/or security agreement in writing and signed by the debtor. Although having an agreement is critical, it cannot alone provide security. It requires one or more of the following methods as well.

2. Possession. The surest way to obtain security for your loan is with a written agreement coupled with possession of a debtor's asset that has an equivalent value to the loan amount. If the debtor defaults (doesn't pay you back), then you can keep the asset. Then, it's just a matter of selling that asset in exchange for cash to get your money back for the loan.

3. Mortgage. The next best way of becoming secured is by filing a mortgage on the real property of the debtor. If possible, the mortgage should be filed immediately (if not prior to the transfer of funds) to make sure that the mortgage is validly filed and that there are no delays or technical flaws that could permit another creditor to obtain a prior and senior lien that has greater rights than your mortgage.

4. Voluntary Judgment. A confession of judgment is a document that results from a voluntary judgment signed by the debtor. The judgment will result



in a lien on the debtor's name and real estate, once docketed. This takes more time than a mortgage to attach to the real estate.

5. Involuntary Judgment. In order to obtain an involuntary judgment, you must file a lawsuit, which may take a lot of time, years in some cases. Once obtained, it has the effect of a lien as described above.

6. Financing Statements. To obtain a lien on debtor's personal property (but not real estate), you must file a financing statement (Form UCC-1). Once filed correctly with the state and county, you will have a recorded security interest in the personal property covered under the statement. This can prevent the sale or transfer of certain property without satisfaction of your lien. But a lawsuit will be necessary to seize the property.

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*An important question to ask before you lend money is
‘what are your rights if that person (the debtor) files for bankruptcy?’*
