Chapter and Verse

New Bankruptcy Law Changes the Rules of the Road

By MICHAEL KATZ, Esq.

The recently signed Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 changes the bankruptcy landscape in this country. It makes it more complex, costly, and time-consuming to file — and it may create more problems than it solves.

On April 20, 2005, President George W. Bush signed a new bankruptcy law with the official title of "The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005."

Approved by the Senate in mid-March, and passed by the House of Representatives in April, President Bush quickly signed the law that had been enacted by Congress. The immediate effect is that filing for personal bankruptcy will be a more complex, costly, and time-consuming process, and the major beneficiary of the new laws will clearly be the banking and credit card industries.

Certain sections of the law became effective upon the enactment on April 20, while other provisions become effective six months from the date of enactment, in October of 2005.

What follows is a breakdown of the bill's provisions and a look at the many ways in which the measure will impact debtors.

Debt to Society

One of the major effects of the new law is that debtors (people filing bankruptcy) who earn more than their state's median income, and who are able to pay a portion of their debt, will be forced into filing Chapter 13 bankruptcy, which requires a repayment plan, rather than Chapter 7, which most often resulted in an ability to eliminate unsecured debts and to obtain a 'fresh start.'

Median household income is the point at which half of all household incomes are greater than that amount, and half of all household incomes have less than that amount. This term refers only to pre-tax income, and does not include the value of non-cash benefits.

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While an exact figure has not yet been announced for Massachusetts, the median income for an individual for the year 2002-2003 in Massachusetts was \$50,976, according to the U.S. Census Bureau. That figure will increase for debtors with more than one person residing in the household. If a person earns more than that amount of money, there will be a presumption that they should file under Chapter 13, and will be required enter into a five-year payback plan as long as the court determines that they can pay at least \$100 per month over those five years.

Presently, Chapter 13 debtors are allowed to provide evidence of their actual expenses in calculating a Chapter 13 plan, but under the new law debtors will be required to make payments based upon Internal Revenue Service guidelines for "reasonable and necessary expenses." Therefore, some government agency will be calculating what it deems sufficient for reasonable expenses for protecting the debtor's family, as well as how much money should reasonably be spent for housing, transportation, food, etc.

Obviously, there are substantial concerns as to how the court will deal with 'abnormal' situations, such as a serious medical problem within a family requiring higher-than-average medical or transportation expenses. Some experts fear that there will be battles over the ability of a family to obtain the prescriptions that are needed for ill children, or that a debtor will be obligated to find a new job rather than spend as much money as he or she presently spends in commuting to a current one.

Also, many Chapter 13s are presently three-year plans, rather than five-year plans, but the new Chapter 13 will most likely require five-year plans in all situations. Since a significant number of Chapter 13 plans presently fail, due to the inability of debtors to maintain the plan payments for such a lengthy period of time, coupled with the economic realities that changes often occur over the five-year period, it is predicted that more Chapter 13s will likely fail in the future under the new law.

Substantial concern has also been raised with regard to the ability of a debtor to protect his or her residence. Under present Massachusetts law, debtors can elect to use the Mass. Homestead Exemption to protect \$500,000 of equity from creditors, either in a bankruptcy or non-bankruptcy situation. Under the present law, and effective immediately from the date the law was signed by President Bush, that figure has been reduced to a maximum of \$125,000 in many situations.

The ability to increase the

$125,000 amount will be dependent upon the length of time that the debtors have owned the home, how long they have lived within the state and the source of the funds used to purchase the residence. This is a major change from the present law protecting residential property from loss when faced with financial difficulties.

Even debtors who still qualify to file Chapter 7 and seek to discharge their unsecured debts will be required to go through mandatory credit counseling. Debtors will have to pay for the credit counseling and undergo the sessions within 180 days before filing for bankruptcy, and they will not be able to obtain a discharge of their debts until they complete a personal financial management course after the case is filed.

While there will be emergency situations that allow credit counseling to be waived for several weeks, those will be the exceptions. The added expense to debtors of the credit counseling will make their ability to file bankruptcy even less likely, since most debtors presently struggle to afford the fees to file bankruptcy.

In this age of worrying about identify theft, another onerous requirement will be that Chapter 7 debtors must provide tax returns to the Bankruptcy Trustee at least seven days before the bankruptcy hearing. They will also be required to provide requested copies of tax returns to creditors. In a Chapter 13 case the debtor must also turn over tax returns for the prior four years when requested by any party.

He or she will also be required to turn over copies of pay stubs and itemized statements of monthly net income as well as other documents, which many people feel is a substantial breach of their privacy rights.

For those debtors hoping to utilize Chapter 13 filings to stop evictions, under the new law, evictions will no longer be stopped if the landlord has obtained a judgment of possession against the debtor before the bankruptcy was filed. Under the present law, if the eviction had not occurred, debtors are frequently allowed to use the Chapter 13 plan to get caught up on their back rent, but will now be more likely to be evicted.

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The Hole Problem

The sad part about the law is that virtually every bankruptcy judge and bankruptcy expert testified against the passage of the bill as drafted, feeling that it did not address the fact that numerous unbiased studies have shown that most personal bankruptcy petitions are filed by people with real financial problems, which are most often the result of family illness, divorce, or loss of jobs.

Numerous amendments were introduced by members of Congress, seeking to modify the provisions for debtors whose financial problems were caused by serious medical problems, or for those people who are acting as caregivers to elderly, sick or disabled people within their family, which is a common occurrence for people filing bankruptcy. Instead, every attempt to modify the bankruptcy bill to deal with these situations, or to also add provisions limiting the amount of interest that could be charged on credit cards and to rein in the amount of unsolicited credit card solicitation that could take place by the banking industry, were immediately defeated.

It is a well-known fact that the banking industry successfully floods families with unsolicited credit offers, looking to lure the elderly, the young, and college students, because they are not fiscally knowledgeable. According to Harvard Law School professor, Elizabeth Warren, while bankruptcy filings did increase 17% since 1997, at the same time credit card profits increased 163%. It was pointed out that paying the minimum credit card payment on a $5,000 balance at the average rate of 21% would require 1,040 payments to pay the debt. Therefore, in addition to the $5,000 principal balance, additional interest would amount to $32,198.66. If there is abuse, it seems to be equally shared by the credit card industry, as well as those debtors who used the credit offers.

The reality is that the average person seeking Chapter 7 bankruptcy relief is faced with serious medical problems, a loss of a job, or a cutback to part-time employment with no benefits, or is a single parent or has recently gone through a divorce proceeding. Therefore, the expectation that these people will be able to put together a five-year repayment plan is unrealistic and unlikely to succeed. While there have been occasional cases of abuse within the bankruptcy system as it previously existed, the majority of those cases were filtered out by a diligent monitoring system conducted by the Office of the United State Trustee and its designated panel of bankruptcy trustees.

It is sugegsted that Congress succumbed to the $24 million that was spent over the past several years by the credit card industry in lobbying for the new bankruptcy bill, coupled with an additional $75,000,000 spent by the banking industry in lobbying Congress.

In the end, the poor, the sick, and the elderly were no match for the behemoth credit card industry. That is the sad reality about the new Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

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