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CONSUMER BANKRUPTCY

The 2004 Congress Moves Quickly to Toughen Bankruptcy Laws

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What Bankruptcy Reform Is About. During the past six years, bankruptcy filings more than doubled to about 1.7 million filings last year. The bankruptcy reform movement, spearheaded by the banking and credit card industries, intensified at the height of this increase when Congress apparently decided that it was time to enact new, more stringent bankruptcy laws designed to make it more difficult for consumers to file for Chapter 7 relief. The reform movement has run a very rocky course ever since.

Bankruptcy reformists, who are generally conservative, pro-business Republicans, are seeking to persuade Congress that the current bankruptcy laws have become too lenient and that a high percentage of filers are abusing the bankruptcy system because they have the ability to repay some of their debts.

In general, the bankruptcy reform movement seeks to prevent a large number of consumers from filing for Chapter 7 relief, which currently enables them to eliminate their credit card debts in full. The proposed new laws require that many of these consumers file a Chapter 13 payment plan bankruptcy instead, forcing debtors to pay off a portion of their debts over a period of

time. If passed, the provisions of the new reform legislation will result in the most sweeping overhaul of the Bankruptcy Code in more than twenty years. President George W. Bush has indicated a willingness to immediately sign any new bankruptcy legislation that is placed on his desk.

How Consumer Bankruptcy Would Be Affected If Reform Legislation is Enacted. The essence of bankruptcy reform is to require consumers to meet certain minimum standards to qualify for Chapter 7 filing. For example, a consumer debtor's income would need to be less than the state's median income in order to qualify for Chapter 7. Also, the new legislation would disqualify consumers from Chapter 7 eligibility if they have the ability to pay at least \$10,000 or 25 percent of their debts, whichever is greater, within three to five years.

Another prerequisite for filing is that the consumer get credit counseling from an approved nonprofit organization. In addition, the new laws will make more consumer credit debts non-dischargeable. Finally, the proposed legislation seeks to hold debtors' attorneys liable for their clients' conduct.

Debtors' attorneys will become responsible for conducting a reasonable investigation into the circumstances giving rise to the filing of the bankruptcy.

Opponents of the bill have argued that it does nothing to end the abuses of banks and credit card companies that flood the mail with solicitations for easy credit and indiscriminately increase lines of credit without conducting due diligence to ascertain if the customer can afford it. Furthermore, some families deemed too rich to qualify for Chapter 7 could be too poor to afford the necessary repayment schedule in a Chapter 13.

Credit card companies have also been making it too easy for college students to begin racking up debt before they even graduate. The law also imposes additional obligations on those seeking to file Chapter 13. Virtually all consumer bankruptcy attorneys and trustees are against bankruptcy reform, as are most bankruptcy judges.

Reform Legislation Has Gathered Momentum. For each of the last six years, it appeared inevitable that new bankruptcy legislation would be enacted by the end of that year. In addition, the pro-bankruptcy reform Bush administration made it more likely that the bankruptcy laws would be overhauled. Interestingly, M.B.N.A., the nation's largest credit card bank, was also the largest contributor to the Bush presidential election.

In the Spring of 2001, the legislation swiftly moved through Congress and the House overwhelming approved the reform bill. It appeared that the bill would become the first major piece of legislation to be signed by President Bush. However, the bill became saddled in the Senate when maverick Vermont Republican Senator Jim Jeffords switched parties, effectively destroying the Republican Senate majority. This had the effect of delaying any forward movement of the bill in the Senate, especially considering that Jeffords' jump shifted leadership of the Judiciary Committee overseeing the bankruptcy bill from Republican to Democrat. Just before the Senate had an opportunity to fully address the bill, the World Trade Center fell and the Pentagon was hit. In the wake of the terrorist attacks of September 11, 2001, bankruptcy reform legislation slipped from the Congressional agenda and again reached another stalemate as new Congressional priorities centered on critical national defense matters related to the attacks.

In 2002, Congress again appeared to come close to approving new legislation. However, our own New York Senator, Charles Schumer, sponsored an amendment aimed at stopping abortion opponents from evading subsequent fines by declaring bankruptcy. Suddenly, the entire debate on bankruptcy reform became consumed by abortion rights arguments. This caused a surprising defeat to the bill.

Enactment Appeared Likely Last Year. In 2003, with Republicans again taking control of the Senate, it appeared even more likely that a new bill would emerge quickly. Spring of 2003 saw the

introduction of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, which was essentially the same bankruptcy reform bill that the Senate passed the previous year. The bill was quickly passed by the House. This was the seventh time in recent years that the House passed an omnibus bankruptcy reform measure. However, the Senate version of the bill never made it through to a vote.

Congress Is Now Speeding Forward in 2004. In a chess-like political move, using a bill to extend farmer bankruptcies, Senate and House Republicans just embarked upon a tricky gambit late last month, in an effort to compel Senate Democrats to vote in favor of the reform bill. Rarely used in New York, Chapter 12 allows farmers to reorganize their debts. It is the only temporary chapter in the federal Bankruptcy Code. It was originally enacted in 1986, but has been regularly extended every time it expired. Chapter 12 just expired again at the end of December and Congress quickly introduced new legislation last month to extend it again.

However, on January 28, 2004, the House voted 265-99 to combine the pending farm bankruptcy bill with the Senate version of the GOP bankruptcy reform legislation, and voted down House Democrat opposition to pass the farm bankruptcy legislation as a standalone bill. Thus, the Capital Hill Republicans are trying to utilize two tricky maneuvers in seeking to force Senate Democrats to accept their version of a bankruptcy bill by combining that legislation with a bipartisan bill offering bankruptcy help for farmers.

First of all, by including the Senate legislation in a House bill, the Republicans are seeking to bypass the Senate's ability to vote on the bill, in effect sending it straight to a joint committee. Second, as there is unanimous bipartisan support for extending Chapter 12 to help farmers, the Republicans are pushing the Senate Democrats to avoid hurting the farmers, by agreeing to the Chapter 11 bill, which now conveniently includes the reform legislation.

However, there is a good chance that

Senate Democrats will object to the Republican effort to move the combined legislation to conference without a Senate vote on the entire package. If the House-passed measure were to move to the Senate Floor, many Democrats would support amendments such as the controversial language by Senator Schumer to make disruptive abortion protesting fines nondischargeable, which is what sidelined the reform legislation in 2002.

Nevertheless, if the Republicans get their way, we may see the reform legislation enacted rather quickly.

Practice Pointer: Prepare Your Clients for Possible Changes in the Law. As many clients procrastinate with finalizing their bankruptcy petition, bankruptcy attorneys should recommend to their clients that they quickly take advantage of the existing laws and play it safe, rather than chance difficulty with newer laws. Although an overhaul of the Bankruptcy Code should certainly have a phase-in period of several months before becoming effective, there have been times in the past when significant changes were made to the bankruptcy laws with very little advance notice. The prudent client seeking bankruptcy relief should not wait too long. I have all my clients sign a notice advising them that the laws may change.

Editor's Note (revised 2008):

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