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CONSUMER BANKRUPTCY

The 2005 Bankruptcy Amendment Act: Winners and Losers

Did the Credit Card and Banking Industries Get What They Bargained For?

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You Don't Always Get What You Wish For. This past April, President Bush signed the most sweeping bankruptcy amendment act in decades, granting the credit card and banking industry's wish for a tougher Bankruptcy Code. For the six months following, the press spouted stories of gloom and doom for consumers seeking to file after October 17, 2005, when the new laws would go into effect. Newspapers painted a grim picture that debt-laden consumers would no longer be able to utilize bankruptcy as a way to alleviate their financial woes. As a result, many consumers developed the impression that bankruptcy was going away for good or that they would no longer qualify.

It initially appeared that the new laws were so harsh and slanted in favor of banks and lenders that bankruptcy for the masses would be a thing of the past. However, now that several months have passed, and some of the dust has settled, it looks like the credit card companies may not necessarily have gotten what they wished for.

Digesting and analyzing the complex, 500-page-long Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was something that most attorneys had put off until after October 17, 2005. After all, there was a mad rush towards the end, of consumers seeking to take advantage of the existing liberal bankruptcy laws, which kept bankruptcy practitioners quite busy.

There was also a dearth of legal education seminars to assist attorneys with learning the intricacies of the new laws. Now that I have taken a number of workshops and courses about the new laws, prepared petitions under the new laws (I was the very first attorney to file a Chapter 7 case in this district under the new act), spoken with trustees and colleagues, reviewed commentary by the academics, and conducted my own analysis of the law, I can make some comments on actual practice under the new laws. Although the 2005 Act is still very early in its infancy, and we have barely seen any case law interpreting it, I am now in a position to glean some winners and losers.

Secured Lenders: Big winners. Automobile loan lenders are perhaps the biggest winners of the 2005 Act as debtors are now obligated to re-affirm debt secured by personal property in order to keep their cars. In addition, secured lenders now have greater rights in receiving payment through Chapter 13 plans than they did previously.

Credit Card Companies: Not the winners they thought they would be. The banking industry that poured tens of millions of dollars into lobbying efforts to get a tougher set of bankruptcy laws probably will not fare as well as they had hoped. For one, the vast majority of consumers will still remain eligible for Chapter 7. Secondly, proponents of the new laws inserted the requirement that debtors fulfill credit counseling requirements ostensibly in the hope of steering a significant number of consumers away from bankruptcy, and into credit counseling payment plans instead.

However, it appears that consumers desiring to file for bankruptcy are going straight to bankruptcy attorneys just as they had done before, and the bankruptcy attorneys are then setting up the credit counseling for them. Thus, credit counseling does not seem to be really acting as a deterrent, and instead, it is just a nuisance.

Consumers: Not the losers that everyone thought they would be. It appears that about 85% of those consumers who could have filed for Chapter 7 relief under the old laws will still be eligible to file for Chapter 7 under the 2005 Act. Perhaps the most dreaded component of the 2005 Act was the means test, a six-page, fifty-five-line item, computational form designed to weed out from Chapter 7 eligibility those consumers who theoretically could afford to pay back a portion of their debts. However, now that the means test has been actually put to use and thoroughly analyzed, it appears that it was poorly constructed and does not totally do the job its proponents expected it to.

For many Long Islanders, the means test will not be a problem because it generously favors homeowners with mortgages and consumers who have car loans or leases. However, consumers who have respectable incomes, but who rent, could end up being ineligible for Chapter 7 compared to similar individuals who pay mortgages and car loans.

It also appears that there may be many loopholes within the means test that will enable a savvy consumer to utilize pre-bankruptcy planning to become eligible for Chapter 7 if they are not already eligible. Although most consumers will still be able to file for Chapter 7, they may be considered losers to the extent that they will have to pay higher legal fees, increased court filing fees, and credit and budget counseling fees.

In addition, they will have to deal with more paperwork and headaches to demonstrate eligibility, as attorneys must verify this information and trustees may want to review it as well. It also appears that the new laws may enable some Chapter 13 debtors to pay less than what they would have paid under the old laws.

Bankruptcy Attorneys: Losers to an extent. Although the 2005 Act will require the attorney to do much more work, and to increase legal fees for all bankruptcy matters as a result, the additional legal fees will not compensate them for this. However, bankruptcy attorneys who concentrate in the field may get more cases because bankruptcy has become too difficult and specialized for the general practitioner.

Attorneys will have more headaches in having to comply with new due diligence requirements to verify the accuracy of information that clients provide. Attorneys will also have more anxiety as the penalties for violating any of the new liability provisions can be strict and can include fee disgorgement plus actual damages including attorney's fees and costs and possible civil penalties
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General Practitioners: Big losers. The complexity of the 2005 Act, together with the new responsibilities that it imposes on counsel, combined with potential attorney liability, has certainly caused most general practitioners to leave the consumer bankruptcy practice. The new bankruptcy laws have just become too difficult for those attorneys who do not regularly handle bankruptcy matters.

Trustees: Losers. Trustees now have more paperwork, yet receive the same fees, and may end up with fewer cases. They are also saddled with additional obligations such as having to notify domestic support creditors and agencies whenever a debtor owes a domestic support obligation. In addition, there are greater confidentiality requirements for any cases involving medical or patient records.

However, before feeling bad for the Chapter 7 trustees, they will certainly be kept rather for busy for months to come because of the business that will be generated by the record number of consumers who flooded the bankruptcy court with filings just before October 17, 2005, seeking to take advantage of filing under the old laws. Perhaps the trustees will find these cases more lucrative because there appear to be more asset cases in that bunch as the result of many cases filed by debtors without attorneys, who did not understand the concept of exemptions.

United States Trustee: Loser. As the ultimate enforcer of policing abusive bankruptcy filings and also having the responsibility to review just about every case in general and appear in all Chapter 11 cases, this office was chronically overworked and understaffed to begin with. Now they have even more work in reviewing the means test filed with each and every case, as well as reviewing cases for substantial abuse under Code section 707(b).

In addition, the 2005 Act imposes many new debtor filing requirements such as filing the credit counseling certificates, income tax returns, proof of pre-petition wages, the means test form, etc. The United States Trustee will probably be the entity that ultimately brings applications to dismiss those cases in which debtors have neglected to timely file the appropriate documents, or they may direct the clerk's office to automatically dismiss a case.

Legal Publishers: Winners. Between Electronic Case Filing and the new laws, you simply cannot do a bankruptcy case any more unless you have the most up-to-date (and expensive) computer software. Gone are the days of grabbing a Blumberg form for a few bucks. The legal publishers have been doing a brisk business selling their updated software.

Innocent Spouses: Partial Winners. The 2005 Act contains a host of provisions designed to protect innocent spouses that the code refers to as "support creditors," basically divorcees and single mothers who are owed child support, alimony or maintenance (the Code now refers to these debts as "domestic support obligations"). However, in some instances, increased protection is illusory as secured creditors such as automobile lenders have greater priority over unsecured priority creditors such as innocent spouses.

Judges: Losers. What judge wants the headache of new laws that are not popular to begin with, are poorly written, have numerous ambiguities and inconsistencies, and do not necessarily help those consumers who the judges have been trying to help for the past several decades. Judges and professors have complained that many provisions of the new law have been drafted atrociously.

Whereas prior legislation was drafted with the assistance of some of the finest minds in the bankruptcy world, the new legislation was mostly drafted by lobbyists with relatively little knowledge of real life bankruptcy practice. I have not heard of a single judge in this country who has had any praise for the new laws.

Dedication to Judge Duberstein. I dedicate this column to the memory of Chief Bankruptcy Judge Conrad B. Duberstein, who died in November at the age of 90. He was extremely well liked for his personable nature and ability to entertain, especially in the courtroom. We have all heard his numerous jokes and anecdotes throughout every proceeding. He made practicing before him an enjoyable experience. He had the rare ability to touch each of us in a special way. We will all miss him

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Editor's Note (revised 2008): Craig D. Robins, Esq., a regular columnist, is a bankruptcy attorney who has represented thousands of consumer and business clients during the past twenty years. He has offices in Medford, Commack, Woodbury and Valley Stream. (516) 496-0800. He can be reached at CraigR@CraigRobinsLaw.com. Please visit his Bankruptcy Website: CraigRobinsLaw.com.