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Consumer Provisions in the Bankruptcy Reform Act of 1999: H.R. 833 and S. 625

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Summary

Bankruptcy reform bills comparable to legislation considered in the 105th Congress were reintroduced early in the 106th Congress. H.R. 833, the "Bankruptcy Reform Act of 1999" was introduced on Feb. 24, 1999. The Senate version, S. 625, was introduced on March 16, 1999. Both bills would effect wide-ranging amendments to the U.S. Bankruptcy Code. With respect to consumer bankruptcy, H.R. 833 would impose a means test to determine debtor eligibility to liquidate under chapter 7. Debtors who do not qualify would be required to reorganize under chapter 13, or refrain from filing.

S. 625 is not identical to H.R. 833. Senate sponsors point to a more liberal means test for chapter 7 filers and additional provisions intended to protect consumers.

The Senate Judiciary committee reported S. 625 favorably on April 27, 1999 by a vote of 14-4. Many of the controversial issues that were not addressed in committee are likely to be debated on the floor and resolved through amendments to the bill.

The House passed its version of bankruptcy reform, H.R. 833, on May 5, 1999 by a vote of 313-108. The bill, a manager's amendment to H.R. 833, is similar to H.R. 3150, passed by the House during the 105th Congress, although several amendments were adopted. The President has threatened to veto the Bankruptcy Reform Act if it is enacted in a form comparable to H.R. 833 as passed by the House.

CRS will update this report.

Legislative history in the 105th Congress. Shortly before the close of the second session of the 105th Congress, legislation which would have dramatically changed the manner in which consumer bankruptcies are administered under the U.S. Bankruptcy Code, 11 U.S.C. § 101 *et seq.* Both the House and Senate enacted different versions of H.R. 3150, 105th Congress, 2d Sess. (1998). A conference was agreed to and a report was filed.[1] The House agreed to the conference report version of the bill by a vote of 300 to 125 on October 9, 1998. But the bill, which President Clinton had threatened to veto, was not brought before the Senate for a vote prior to adjournment.[2]

Although the Senate and House bills differed significantly, they were referred to as implementing "needs based" bankruptcy, *i.e.*,a consumer bankruptcy system that differentiates among debtors and, by application of external jurisdictional standards or through case-by-case scrutiny, strives to ensure that creditors receive a higher distribution than they might otherwise.

H.R. 833, 106th Congress, 1st Sess (1999): The Bankruptcy Reform Act of 1999. H.R. 833, like its predecessor, H.R. 3150, is a comprehensive bill addressing consumer practice under chapters 7 and 13, and business bankruptcy reform. With respect to consumer bankruptcy, a great deal of the impetus towards legislative action has been fueled by the ever-increasing rate of consumer bankruptcy filings.[3] Congressional debate over bankruptcy reform during the 105th Congress repeatedly evidenced a desire by Members to elevate personal responsibility in consumer financial transactions; to prevent bankruptcy filings from being utilized by consumers as a financial planning tool rather than a last-resort solution to personal financial crisis; and, to recapture the stigma associated with a bankruptcy filing, which many perceive to have eroded since enactment of the U.S. Bankruptcy Code in 1978.

Opponents of the legislation argue, *inter alia,* that the growth in consumer bankruptcies is not a result of liberal bankruptcy laws but is the consequence of greatly expanded consumer credit and high-risk lending practices; that the imposition of a means test will permit debtors to manipulate jurisdictional filing criteria; that undermining the "fresh start" in bankruptcy by making commercial debt nondischargeable will adversely impact debtors' family support obligations; and, that the increased cost of administering the U.S. Bankruptcy Court system will not be justified by the incremental increase in debt recovery realized by creditors.

Several days of hearings during the 106th Congress have elicited testimony by many experts which suggests significant disagreement over the causes of increased consumer filings and the most effective way to enhance debt repayment.[4]

Highlights of Consumer Bankruptcy Provisions in the Bill Passed by the House. *Presumptive abuse.* H.R. 833 utilizes the means testing formula similar to that of the conference version of H.R. 3150. The bankruptcy trustee would make a preliminary determination whether the debtor's filing under chapter 7 debtor was an "abuse" of the

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[1] H.Rept. 105-794, 105th Cong., 2d Sess. (1998).

[2] "*Bankruptcy Reform Bill's Fate in Doubt; Congress, Administration Seek Middle Ground,*" 10 BBLR 1044 (October 15, 1998).

[3] H.Rept. 105-540, 105th Cong., 2d Sess. 54-55 (1998) to accompany H.R. 3150; S.Rept. 105-253, 105th Cong., 2d Sess. 22 (1998) to accompany S. 1301.

[4] On March 11, 1999, House and Senate Judiciary Subcommittees held a joint bankruptcy hearing. The House Subcommittee on Commercial and Administrative Law held additional hearings on March 16, 17, and 18.

Code.[5] The definition of "abuse" under 11 U.S.C. § 707, however, would be amended.[6]

In summary, "abuse" would be presumed for a chapter 7 filing if the debtor met the following criteria:

- If the debtor's monthly income — calculated under a five-year repayment plan under chapter 13 — would leave him or her with an ability to pay $100 per month in disposable income, after factoring in deductions for living expenses, private school tuition, payments to secured creditors, and payment of priority claims, such as child support and alimony;

- The debtor's living expenses would be calculated by referral to Internal Revenue Service living standard allowances (which are used to determine a taxpayer's ability to pay delinquent taxes), not by reference to the debtor's actual historical living expense experience. In other words, the law would assume that debtors and their families can live for five years within the budgets established by the IRS living allowances;

- If a debtor believes that he or she cannot live within the IRS living allowance standards, he or she must demonstrate the existence of "extraordinary circumstances that require additional expenses or adjustment of current monthly total income."

If the debtor's current monthly income, calculated within these parameters, left the debtor with $100 per month, then the debtor would meet the "presumptive abuse" standard. The debtor would be required either to file under chapter 13, or to refrain from filing for relief under the U.S. Bankruptcy Code.

Extraordinary circumstances. The debtor could rebut the presumption of abuse by demonstrating "extraordinary circumstances" that require additional expenses. That showing would require extensive evidentiary proof, attestation under oath by the debtor and the debtor's attorney, and the net effect of rendering the debtor unable to pay off $6000 of unsecured claims over five years.

Plan duration. Chapter 13 reorganization plans currently are permitted to be completed within a three year time frame, with a possible extension to five years "for cause."[7] Under the bill, the duration period will be five years if the debtor's current monthly income "is not less than the highest national median family income."[8] Hence, the length of a confirmation plan will depend upon the debtor's current monthly income at the time of plan inception.

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[5] 11 U.S.C. § 707.

[6] H.R. 833, § 102.

[7] 11 U.S.C. § 1322(d).

[8] H.R. 833, § 606.

Child support and alimony. *First priority to domestic support obligations.* Under current law, first priority is allocated for "administrative expenses."[9] This category includes compensation for professionals who render services to the bankruptcy estate, including the trustee. H.R. 833 subordinates administrative expenses to second priority, and establishes domestic support obligations as the first priority.[10] Payments owed to state welfare departments would be included. While this would, of course, elevate the status of domestic support obligations in bankruptcy, there was testimony before the House Subcommittee on Commercial and Administrative law that the financial incentive for trustees to serve the estate — including his or her ability to investigate and recover fraudulent transfers — may suffer if there are not sufficient funds to pay support and to compensate them and other professionals for their efforts.[11]

Nondischargeable unsecured debt. Two provisions of the bill enlarge the class of debts which would become nondischargeable in bankruptcy. Consumer debts owed to a single creditor aggregating more than $250 for "luxury goods" incurred within 90 days before the filing are presumed to be fraudulent, and would become nondischargeable.[12] Current law presumes that consumer debts or cash advances owed to a single creditor for more than $1000 that are incurred within 60 days of bankruptcy are nondischargeable.[13]

And debts (presumably credit card debts) incurred to pay a debt that is nondischargeable would also become nondischargeable if the debtor incurred the debt "to pay such a nondischargeable debt with the intent to discharge in bankruptcy the newly-created debt" or incurred the debt within 90 days of filing.[14] It is not clear how the debtor would prove, or disprove, that he or she intended to discharge the debt in bankruptcy when it was incurred.

Secured creditors. The position of secured creditors would be greatly enhanced under the bill. Under current law, the claim of a secured creditor is only "secured," that is, legally protected up to the market value of the collateral. The law currently assumes that the amount that the creditor would likely realize for the property if the debtor returns the secured property to the creditor is the value of the claim, and an unsecured claim for the difference between the collateral's market value and the contract price that the debtor agreed to pay. In chapter 13, a debtor is permitted to "cramdown" claims against some secured creditors. This means that the creditor must accept payments equal to the value of the collateral as full payment on the claim. Under the bill, a debtor would not be permitted to "bifurcate" or "strip the lien" on the secured claim, that is, divide it into a secured and unsecured amount if the debtor purchased the item within 5 years of the filing. The debtor, in most cases, would be required to pay the full contract price, and in some

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[9] 11 U.S.C. § 507(a)(1).

[10] H.R. 833, § 139.

[11] *See,* Testimony of Robert Waldschmidt, Pres., National Assoc. of Bankruptcy Trustees, before the House Subcomm. on Commercial and Administrative Law, Wed., March 17, 1999 at <www.house.gov/judiciary/106-wald.htm>.

[12] H.R. 833, § 133.

[13] 11 U.S.C. § 523(a)(2)(C).

[14] H.R. 833, § 146.

cases, the retail price of the item if he or she wished to retain it.[15] The enhanced value of secured claims under the bill is likely to diminish the amount of pay out to unsecured creditors in the bankruptcy.

S. 625, 106th Congress, 1st Sess. (1999), the Bankruptcy Reform Act of 1999. Although S. 625, introduced by Senators Grassley, Torricelli, and Biden, is similar to H.R. 833, the bill was modified prior to introduction to accommodate the concerns raised by some Senators.

In his introductory statement, Sen. Grassley notes several features which differentiate the Senate and House bills:[16]

- The Senate bill gives more flexibility to the bankruptcy judge to determine whether a debtor is effecting an "abusive" chapter 7 filing;

- There are greater consumer protections in the Senate bill addressed at curbing abusive and illegal creditor behavior to coerce debtor reaffirmation of dischargeable debt. For example, the Justice Department and the FBI are directed to appoint prosecutors and agents to investigate abusive or deceptive reaffirmation practices; and, state attorney generals are given express authority to enforce remedies for abuse of reaffirmation protections in the bankruptcy code;[17]

- Bankruptcy trustees would be required to notify state enforcement agencies of a bankrupt's address and telephone number if the bankrupt owes child support. This is designed to promote help by bankruptcy courts in tracking down "dead-beat" parents;[18] and

- Although the Senate bill, like H.R. 833, provides that certain debts incurred prior to bankruptcy to pay off nondischargeable debts will also be nondischargeable (even though they are dischargeable under current law), those debts will *remain* dischargeable if the debtor owes child support. This is intended to protect the interests of child support recipients post-bankruptcy.[19]

Presumed abuse. S. 625 does not automatically subject debtors to a means test in order to determine eligibility to file under chapter 7. Instead, it permits a party in interest, including a creditor, to challenge the debtor's "ability to pay." When a party raises the issue, the court will presume abuse if, by applying calculations similar to those in H.R. 833, including reliance on IRS living standard allowances, the court finds that the debtor's monthly income would leave him or her with an ability to pay 25% of nonpriority unsecured claims or $250 per month in disposable income (whichever is less).

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[15] Id., §§ 122, 123.

[16] 145 CONG. REC. S2738 (daily ed., March 16, 1999)(Statement of Sen. Grassley).

[17] S. 625, §§ 203, 204.

[18] Id., § 219.

[19] Id., § 314.

Plan duration. S. 625 extends the three year term of a chapter 13 repayment plan to five years "for cause," as in current law, but requires the longer term when the case has been converted from one under chapter 7.[20]

Homestead exemption. Last year's Senate-passed version of H.R. 3150 placed a $100,000 cap on homestead exemptions under state law. The conference version did not include a monetary cap, but did impose longer residency requirements in order to take advantage of a state homestead exemption. H.R. 833 imposes a $250,000 cap on homestead exemptions under state law, but would permit the states to enact laws exempting their residents from the federal cap.[21] S. 625 as reported by the Senate does not appear to impose a monetary cap on state homestead exemptions.

Treatment of secured debt and nondischargeable unsecured debt. S. 625 does have provisions comparable to those in H.R. 833 with respect to limitations on cramdown of secured creditors,[22] and expanded categories of nondischargeable debt.[23]

Bankruptcy reform legislation appeared to enjoy wide-spread support during the 105th Congress. Sen. Torricelli, a co-sponsor of S. 625, has indicated, however, that there are still many important outstanding issues that need to be addressed as the legislation moves forward. These may include determining the appropriate degree of judicial discretion in the application of a means test; the appropriateness of applying IRS living allowances to bankruptcy debtors; the appropriate scope of nondischargeable debt; and, whether or how abusive practices by the credit industry should be addressed.[24]

Senate Judiciary Committee mark-up. The bill was reported out of committee with relatively few amendments.[25] Proceedings before the Senate Judiciary Committee suggest that Members may still be divided over many issues, including the use of IRS living expense standards and other calculations for means testing, the need for a monetary cap on state homestead exemptions, attorney liability for debtor filings, mandatory credit counseling, reaffirmation agreements, and consumer protections against credit card lending practices. These issues, and many others, are likely to be addressed in amendments submitted when the bill comes to the floor.

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[20] Id., § 318.

[21] H.R. 833, § 147.

[22] S. 625, §§ 306, 309.

[23] *See, e.g.,* id., §§ 310, 314.

[24] Letter from Sen. Torricelli to Sen. Grassley, March 17, 1999.

[25] S.Rept. 106-49 (1999).