

“NOT DEAD YET:” BANKRUPTCY AFTER BAPCPA

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The Dead Collector: Bring out yer dead.
Large Man with Dead Body: Here's one.
The Dead Collector: That'll be ninepence.
The Dead Body That Claims It Isn't: I'm not dead.
The Dead Collector: What?
Large Man with Dead Body: Nothing. There's your ninepence.
The Dead Body That Claims It Isn't: I'm not dead.
The Dead Collector: 'Ere, he says he's not dead.
Large Man with Dead Body: Yes he is.
The Dead Body That Claims It Isn't: I'm not.
The Dead Collector: He isn't.
Large Man with Dead Body: Well, he will be soon, he's very ill.
The Dead Body That Claims It Isn't: I'm getting better.

—from Monty Python and the Holy Grail (1975)

Rumors abound that people cannot file for bankruptcy relief since the Bankruptcy Abuse Protection and Consumer Protection Act (“BAPCPA”) took effect on October 17, 2005, or that a bankruptcy filing is too difficult to make it a good option for consumers with financial difficulties. Like “The Dead Body That Claims It Isn't,” however, bankruptcy isn't dead. In fact, it isn't even ill. The protections that bankruptcy offers are alive and well, and still available to help us help our clients.

A Brief History of Bankruptcy

Bankruptcy originated in the Old Testament. While the Bible tells us to pay our just debts, it also recognizes that there is a time when debt should be forgiven. Deuteronomy 15:1–2 clearly provides for a discharge of debts: “At the end of every seven years you shall grant a release. And this is the manner of the release: every creditor shall release what he has lent to his neighbor, his brother, because the Lord's release has been proclaimed.” Under this law, debt was wiped out every seven years, regardless of circumstances. And, while Old Testament lenders were admonished to be merciful, debts were canceled every seven years whether they liked it or not. Many people believe that the reference to Chapter 7 in our modern bankruptcy laws is based on the 7 year term provided for in Deuteronomy.

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The New Testament also includes the concept of forgiveness of debt, most prominently in the Lord's Prayer: "Forgive us our debts as we have also forgiven our debtors."

The Biblical model can be applied to modern bankruptcy laws. The principle is that, while taken seriously, debt can be canceled to achieve some higher purpose—from encouraging entrepreneurial risk to the simple recognition that bad things happen and people are entitled to a fresh start.

Such an enlightened approach did not always hold sway, as reflected by the etymological roots of the word "bankruptcy". "Banca rotta," Latin for "broken board," reflects the custom in Medieval Italy for angry creditors to break the work benches of defaulting merchants over their heads. The French word "banqueroute" referred to debtors who fled town without paying their debts and lived off their ill-gotten gains.

The need for bankruptcy was recognized in the U.S. Constitution. Article I, Section 8 gives Congress the power to: "[E]stablish... uniform Laws on the subject of Bankruptcies throughout the United States." During America's early history, bankruptcy relief was limited to merchants, and a bankruptcy could only be brought by creditors against commercial debtors; voluntary petitions were not allowed. Not until the groundbreaking 1841 Bankruptcy Act were voluntary consumer petitions allowed for the first time.

Bankruptcy was still a rarely-used consumer option until the Bankruptcy Act of 1978, which created the basic structure for the system we have today. It established the two Bankruptcy Code sections that are used by most consumers: Chapter 7 and Chapter 13.

Chapter 7 is what most people think of when they think of bankruptcy. In a Chapter 7 all of the debtor's assets—with the exception of exempt items or assets with no equity—can be sold and the proceeds distributed among creditors. Despite being called a liquidation, in most consumer cases all assets are exempt or have no equity (and are retained by the debtor), and creditors receive no distribution. This is called a "no asset" bankruptcy. A typical individual no-asset Chapter 7 bankruptcy lasts about four months. A more detailed discussion of the Chapter 7 discharge may be found *supra*.

Often called a "wage-earner plan," Chapter 13 allows debtors with a regular source of income to catch up on mortgage, car, tax and domestic support payments, repay creditors, and keep all of their assets. A more detailed discussion of Chapter 13 cases may be found *supra*. Most Chapter 13 bankruptcies last three to five years, although active attorney involvement normally ends after the Court approves the

repayment plan, about four months after the case is filed. In appropriate cases, no interest accrues on the amounts being paid through the Chapter 13 Plan and unsecured creditors receive less than the full balance due.

BAPCPA

The 1994 revisions to the Bankruptcy Code modified, streamlined and clarified requirements for both business and consumer bankruptcies. In the eyes of most bankruptcy judges, academicians and practitioners, the bankruptcy system worked fairly well after the 1994 Act.

It was thus rather disturbing when, on October 17, 2005, the misnamed “Bankruptcy Abuse Prevention and Consumer Protection Act” (BAPCPA) went into effect. It was misnamed because it did little to prevent bankruptcy abuse, while being virulently anti-consumer. As Bankruptcy Judge Frank Morris put it, “the legislation’s adoption in its title of the words ‘consumer protection’ is the ‘grossest of misnomers.’” *In re Sosa*, 336 B.R. 113 (Bankr. W.D.Tex. 2005). In a recent NACBA poll, 92.8% of consumer bankruptcy attorneys surveyed believed that the additional paperwork required by BAPCPA increased debtor costs without reducing abuse.

Since its passage, much mis- and disinformation has circulated about BAPCPA’s effects, with clients indicating that the primary sources are collection agents anxious to prevent consumers from filing for bankruptcy relief. Among the falsehoods clients report being told are:

- Bankruptcy laws have been repealed;
- Only corporations can file for bankruptcy;
- Credit card bills cannot be discharged;
- Medical bills cannot be discharged;
- Taxes cannot be discharged;
- Foreclosures cannot be stopped by bankruptcy; and
- A written test must be passed before bankruptcy can be filed.

All of these statements are false.

In fact, although the changes imposed by BAPCPA are significant from a practice perspective and require much additional work by counsel, for the vast majority of clients the process is largely the same as it was.

Changes Affecting Consumer Debtors

The principal BAPCPA changes impacting consumer debtors are:

Credit Counseling. Before an individual can file for Chapter 7 or 13, he or she must complete a Credit Counseling course. The course usually lasts for 45–90 minutes, and can be taken by telephone or over the internet. A Credit Education course must also be taken before a debtor can receive a discharge.

Means Test. If a debtor’s “household income”—determined by a formula that may have little to do with actual income—is less than the median family income in his or her state, the debtor may file for Chapter 7. Social Security income is excluded from this calculation. Even if the debtor’s household income exceeds these figures, various deductions, based on a combination of actual expenses and IRS allowances, can still allow the debtor to file for Chapter 7. If the debtor “fails” the means test, he or she may be required to file for Chapter 13, in which the Means Test may be used to determine the length or funding of the Chapter 13 Plan.

The Means Test has had little practical impact on debtors. The vast majority of Chapter 7 filers fall under the median family income, which in Maryland is \$48,929 for a family of one and \$75,764 for a family of three. In Chapter 13s, payment and term are largely governed by criteria other than those imposed by the Means Test. Of more concern to most bankruptcy practitioners is the significant amount of time it takes to complete what is largely a useless form.

Tax Returns and Proof of Income. A debtor must give the Trustee copies of recent tax returns, and may be required to file returns for unfiled previous years. Copies of paystubs must be provided for the 60 days before the case was filed. If these documents are not timely provided, the case is subject to *automatic* dismissal.

Domestic Support Obligations. Domestic Support Obligations (usually alimony, child support and property distribution) are, at least technically, given payment priority over other creditors.

Cramdowns. Before BAPCPA, Chapter 13 debtors could often “cramdown” PMSI loans, allowing the debtor to pay the value of an item, instead of the (often much higher) loan amount. BAPCPA prohibits cramdowns on cars purchased for the personal use of the debtor less than 910 days before the case was filed where no other collateral was pledged for the loan. Cramdowns on any PMSIs given less than one year before the case was filed are not allowed. Interest rates may still be reduced, and in some jurisdictions, though Maryland has yet to rule, a so-called 910 vehicle may be surrendered in full satisfaction of the loan.

Refiling Restrictions. BAPCPA limits the applicability of the automatic stay if a debtor files for bankruptcy and had a bankruptcy case pending during the previous year. If one case was pending, the automatic stay terminates as to the debtor (but may not terminate as to “property of the estate”) after thirty days, unless the Court holds a hearing during that period and the debtor demonstrates by clear and convincing

evidence that the new case was filed in good faith. If there were two cases pending, the automatic stay does not go into effect at all, although the Court may reimpose it in appropriate circumstances.

A debtor may receive a Chapter 7 discharge once every eight years, up from six years pre-BAPCPA. A Chapter 13 case can still be filed, even if the debtor is ineligible for a Chapter 7 discharge. “Chapter 20’s” (a Chapter 7 to discharge general unsecured debt followed in short order by a Chapter 13 to pay priority or secured debt) are still allowed, subject to the automatic stay restrictions discussed above. The availability of a discharge in the Chapter 13 portion of such cases has also been restricted.

Changes Affecting Debtor’s Counsel

In addition to its direct impact on consumer debtors, BAPCPA imposes significant changes on how debtor’s counsel disclose, counsel, draft and plan with their clients. These changes are largely unseen by most debtors, although they are felt significantly by counsel.

The principal change impacting counsel is the “Debt Relief Agency” requirement. With few exceptions, a law firm providing “bankruptcy assistance” to a “potential assisted person” (PAP) in return for payment is considered a “debt relief agency” (DRA), and is required to comply with a plethora of restrictions, requirements and disclosures. Of great concern is the fact that, due to poor drafting, these requirements are not limited to those who represent consumer debtors in bankruptcy proceedings. Rather, *anyone* providing *any* information or advice about bankruptcy issues to consumers may be considered a Debt Relief Agency, and fall under the BAPCPA requirements. Even creditors, under some circumstances, may be considered DRAs.

Being a DRA imposes numerous requirements. Several are currently on challenge in various courts, and some have been stricken, although there are no appellate decisions as of January 2007. Among these requirements are:

- All advertising must substantively state, “We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.”
- Voluminous written disclosures must be provided PAPs within three business days after the first offer to provide bankruptcy assistance.
- A written contract must be executed with a PAP within five business days after the first offer to provide bankruptcy assistance.

- A DRA may not advise a PAP to incur more debt in contemplation of a bankruptcy filing. This seemingly includes even advising a PAP to sell an expensive car and buy a less expensive vehicle.

It should be noted that, although the DRA requirements are expansive, and the penalties for infringement are significant, their enforcement to date has been virtually non-existent. The author is unaware of any court proceeding brought for DRA violations against bankruptcy practitioners, let alone against non-bankruptcy counsel who may run afoul of their broad language.

In addition to the DRA impositions, the additional tasks under BAPCPA required of consumer bankruptcy counsel to counsel clients, and to prepare, file, conduct and conclude bankruptcy cases, have increased greatly. Although a detailed discussion is beyond the scope of this article, these requirements have approximately doubled the attorney and staff time necessary to shepherd a case from the initial client contact through discharge, with no comparable gains in preventing abuse or benefit to debtors.

Pre-BAPCPA, competent bankruptcy representation could often be provided by a general practitioner who handled the occasional simple case. BAPCPA has made this largely a thing of the past. The pitfalls and traps in the new Code for the casual practitioner, the numerous additional requirements, and the DRA mandates, have created a sea change in how debtors are represented. Consumer bankruptcy law is now much more of a specialty than it used to be. Retention of experienced counsel, and involvement early in the process is crucial, and can allow the changes imposed by BAPCPA to be dealt with smoothly and with little impact on most debtors.

Bankruptcy Continues to Offer Substantial Benefits

Bankruptcy continues to offer strong protections for those in financial distress. Despite the additional hurdles BAPCPA imposes, once these hurdles have been surmounted—something an experienced bankruptcy attorney can usually do as a matter of course—the core consumer protections of the Bankruptcy Code remain. These are the Automatic Stay, the Chapter 7 discharge and Chapter 13 repayment plans.

The Automatic Stay

Filing for bankruptcy imposes the Automatic Stay, an injunction against the initiation or continuance of collection action by most creditors against the debtor or his or her property. As the Court stated in *Williford v. Armstrong World Industries*, 715 F.2d 124, 127 (4th Cir. 1983):

The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from its creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.

The Stay makes most creditor actions taken after the case is filed void or voidable. It allows the Court to deal with the debtor's assets and creditors in a single forum, where the rights of all concerned can be balanced and there is no "rush to the Courthouse". In Chapter 13, the Stay also protects co-debtors who are liable with the debtor on consumer debts.

The filing of bankruptcy and resulting automatic stay stops pre-suit collection activities, such as dunning calls and letters. It puts lawsuits on hold. It halts post-judgment activities, such as lien filings, garnishments and attachments. It stops actions against a debtor's property, such as foreclosures and repossessions. These provisions make bankruptcy an attractive option for debtors being harassed by creditors, those with claims and judgments against them, or those who simply cannot pay their bills.

The Chapter 7 Discharge

At the conclusion of a bankruptcy case, most debtors receive a discharge. The discharge replaces the automatic stay with a permanent injunction prohibiting creditors from taking any of the actions the automatic stay prohibited as to most debts.

Some types of debts are not discharged, principally certain taxes, domestic support obligations and student loans, and the collection of these debts may resume once the debtor's case is closed. Unless avoided during the bankruptcy, creditors can also execute on liens that existed pre-filing.

Violators of the discharge are liable for actual damages caused by their actions, and may be assessed punitive damages and attorney's fees.

Chapter 13 Repayment Plans

A Chapter 13 offers consumer debtors a number of advantages. It is often used by homeowners who fall behind on mortgage payments to stop foreclosure proceedings, allowing the cure of mortgage arrearages over time, typically five years. Chapter 13 allows auto loan, tax and domestic support arrearages to be paid over the same period, stopping all collection activities. Chapter 13 also protects third parties who are jointly liable with the debtor on consumer debts, such as co-signers. In some

respects, a Chapter 13 acts like a consolidation loan, allowing the debtor to make payments to a Chapter 13 Trustee who then distributes them to creditors.

Once a case is filed, the debtor proposes a Chapter 13 Plan, which describes how debts will be repaid and in what amount. Some priority debts, such as certain taxes and domestic support obligations, must be paid in full over time. If the debtor wants to keep a house or car where payments are behind, the arrearages must be paid in full over time and the debtor must resume making the normal monthly payments. Unsecured debts, such as credit cards and medical bills, can be paid anywhere from nothing to the full amount, depending on the details of the case. And, in one of the very few consumer-friendly changes adopted by BAPCPA, the willful failure of a creditor to properly credit payments made under a confirmed Chapter 13 Plan that causes material injury to the debtor gives rise to damages.

Conclusion

To paraphrase Mark Twain, the reports of bankruptcy's death since BAPCPA are greatly exaggerated. Bankruptcy was in existence in Biblical times, was specifically provided for in the U.S. Constitution, and has been an important "safety valve" for modern consumers. Congress cannot outlaw the medical problems, job loss or domestic issues that cause the vast majority of people to file for bankruptcy relief.

While this relief may have made somewhat more difficult by BAPCPA, it continues to remain a valuable means of restructuring or eliminating debt, preventing foreclosures and repossessions, and giving clients a fresh start.