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## **Consumer Bankruptcy Reform in the 109<sup>th</sup> Congress: Background and Issues**

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Robin Jeweler  
Legislative Attorney  
American Law Division

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## Summary

2005 marks the eighth year in which consumer bankruptcy reform legislation is to be considered. On February 1, Sen. Grassley introduced S. 256, 109<sup>th</sup> Cong., 1<sup>st</sup> Sess. (2005), the “Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.” Originally introduced in 1998 as part of a large omnibus bankruptcy reform bill, legislation came close to enactment in both the 106<sup>th</sup> and 107<sup>th</sup> Congresses. The legislation appeared to lose some momentum during the 108<sup>th</sup> Congress. H.R. 975, 108<sup>th</sup> Cong., 1<sup>st</sup> Sess. (2003), was passed by the House early in 2003 but was never taken up by the Senate.

Since its introduction in 1998, the various versions of bankruptcy reform have incorporated many amendments but have retained core features. Predominant among them is a complex “means test” for prospective debtors to determine whether they may file under chapter 7 governing liquidation. Failure to satisfy the means test is presumptive abuse of chapter 7, and the disqualified debtor either must file for reorganization under chapter 13 or refrain from filing.

The legislation considered by previous Congresses was broad and addresses many areas of bankruptcy practice beyond consumer filings. Topics included small business bankruptcy, tax bankruptcy, ancillary and cross-border cases, financial contract provisions, amendments to chapter 12 governing family farmer reorganization, and health care and employee benefits. A comparable bill may be introduced in the 109<sup>th</sup> Congress.

This report reviews the historical context which forms the background for renewed consideration of consumer reform legislation, including a review of the current law and a survey of selected issues that have been the focus of legislative debate in the past, such as the scope of the homestead exemption, nondischargeability for liability incurred by violent activity, and the protection of child support payments. It will not be updated regularly.

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# Consumer Bankruptcy Reform in the 109<sup>th</sup> Congress: Background and Issues

## Introduction

**Background.** 2005, the First Session of the 109<sup>th</sup> Congress, marks the eighth year and the fourth Congress in which consumer bankruptcy reform legislation is to be considered. On February 1, Sen. Grassley introduced S. 256, 109<sup>th</sup> Cong., 1<sup>st</sup> Sess. (2005), the “Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.”<sup>1</sup> Originally introduced in 1998 as part of a large omnibus bankruptcy reform bill, the legislation came close to enactment in both the 106<sup>th</sup> and 107<sup>th</sup> Congresses. At the conclusion of the 106<sup>th</sup> Congress, a conference report bill was passed by both the House and the Senate, but was pocket vetoed by President Clinton. Late in the 107<sup>th</sup> Congress, an informal compromise between representatives of the House and the Senate over the “Schumer Amendment” — a provision intended to prevent the discharge of liability for willful violation of protective orders and violent protests against providers of “lawful services,” including reproductive health services — proved unacceptable to the House. Consequently, the conference report on H.R. 333, 107<sup>th</sup> Cong., 1<sup>st</sup> Sess. (2001), did not come up for a vote in either chamber. The legislation appeared to lose some momentum during the 108<sup>th</sup> Congress. H.R. 975, 108<sup>th</sup> Cong., 1<sup>st</sup> Sess. (2003), was passed by the House early in 2003 but was never taken up by the Senate.

Since its introduction in 1998, the various versions of bankruptcy reform have incorporated many amendments, but the legislation has retained core features. Predominant among them is a complex “means test” for prospective debtors to determine whether they may file under chapter 7 governing liquidation. Failure to satisfy the means test is presumptive abuse of chapter 7, and the disqualified debtor either must file for reorganization under chapter 13 or refrain from filing.

The legislation considered by previous Congresses was broad and addressed many areas of bankruptcy practice beyond consumer filings. Topics included small business bankruptcy, tax bankruptcy, ancillary and cross-border cases, financial contract provisions, amendments to chapter 12 governing family farmer reorganization, and health care and employee benefits. A comparable bill may be introduced in the 109<sup>th</sup> Congress.

This report reviews the historical context which forms the background for renewed consideration of consumer reform legislation, including a review of the current law and a survey of selected issues that have been the focus of legislative debate in the past.

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<sup>1</sup> 151 CONG. REC. S768 (daily ed. Feb. 1, 2005).

## Current Consumer Bankruptcy Practice

The current U.S. Bankruptcy Code, 11 U.S.C. § 101 *et seq.*, was enacted in 1978.<sup>2</sup> It replaced and repealed in its entirety the pre-existing Bankruptcy Act of 1898.<sup>3</sup> In 1970, when Congress perceived the need to modernize the bankruptcy laws, it created a Commission on the Bankruptcy Laws of the United States to study and recommend changes in the law. The Commission filed its final report with the Congress on July 30, 1973.<sup>4</sup> In 1994, Congress created another commission, the National Bankruptcy Review Commission (NBRC), to study and report recommendations for legislative change. The NBRC issued its report on October 20, 1997.<sup>5</sup> In a lengthy report of approximately 1300 pages, the Commission adopted as many as 172 recommendations dealing with, *inter alia*, consumer bankruptcy, business bankruptcy, municipal bankruptcy — as well as bankruptcy jurisdiction, procedure, and administration. However, in the case of consumer bankruptcy reform, the Commissioners were generally not in agreement.<sup>6</sup>

**Consumer Filing Options.** Consumer debtors usually avail themselves of one of two operative chapters of the Code. Chapter 7 involves liquidation of the debtor's assets and distribution of proceeds. Chapter 13 involves reorganization, under which a debtor's debts are restructured and paid over time in accordance with a set payment plan. Chapter 11 governs business reorganization. Although an individual may file under chapter 11, its procedures and costs are significantly greater and more complex.

**Chapter 7.** Chapter 7 of the Code governs liquidation of the debtor's estate and is often referred to as "straight bankruptcy." Under the supervision of a standing trustee, the debtor's assets are liquidated, i.e., reduced to cash, and the proceeds are distributed to creditors in accordance with the procedures mandated. At the conclusion, the debtor receives a "discharge," which operates as a permanent injunction against any attempt by a creditor to collect discharged debts.

**Chapter 13.** Chapter 13 has a jurisdictional threshold for filing. It is limited to an individual (and spouse) with regular income whose aggregate unsecured and secured debts are less than \$307,673 and \$922,975 respectively. 11 U.S.C. § 109.

Chapter 13 contemplates a more expedited and streamlined procedure for individual (i.e., consumer) reorganization than that provided for under chapter 11,

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<sup>2</sup> The Bankruptcy Reform Act of 1978, P.L. 95-598, 92 Stat. 2549 (November 6, 1978).

<sup>3</sup> 30 Stat. 544 (July 1, 1898).

<sup>4</sup> Report of the Commission on Bankruptcy Laws, H.R. Doc. No. 137, Parts I and II, 93<sup>rd</sup> Cong., 1st Sess. (1973).

<sup>5</sup> "Bankruptcy: The Next Twenty Years," National Bankruptcy Review Commission Final Report (Government Printing Office, October 20, 1997).

<sup>6</sup> See "Recommendations for Reform of Consumer Bankruptcy Law by Four Dissenting Commissioners," *id.*

which is designed to accommodate business reorganization.<sup>7</sup> In contrast to chapter 11, a chapter 13 reorganization always requires the participation of a standing trustee. It does not establish creditor committees, nor do creditors vote to accept or reject a plan of reorganization, although they are given the opportunity to accept certain provisions and interpose objections. Only the debtor may propose the reorganization plan, which must be completed within a specified three to five year time frame. A debtor receives a discharge of indebtedness not upon confirmation, but upon completion of all payments under the plan.

Plans are generally required to be completed within three years of the first payment under the reorganization plan, unless the debtor requests and the court approves a modification to extend it for up to, but no longer than five years. 11 U.S.C. § 1329.

## **Distinctive Features of the U.S. Bankruptcy Code.**

Many features of bankruptcy administration under the Code lead to disparities in the financial outcome of debtors who undergo reorganization. However, many of these provisions have their genesis in considered, deliberate policy and political decisions. We examine several which are relevant to consumer bankruptcy filings.

**The Function of Exclusions and Exemptions in Bankruptcy.** The U.S. Bankruptcy Code, by design, is *not* an equalizer of wealth among all bankruptcy debtors. Each bankruptcy is highly fact specific; but as a general proposition, a debtor who enters bankruptcy with more wealth is likely to emerge from bankruptcy with more assets intact. Any disparity in the outcome among consumer bankruptcy debtors is, in large part, a function of the bankruptcy system of exclusions and exemptions.

A legal treatise observes that “[f]ew people would voluntarily take any legal action which meant the surrender of so much of their possessions as to leave them destitute and virtually helpless.”<sup>8</sup> Hence, when an individual debtor’s assets are liquidated, the law permits him or her to retain a certain minimum of money and property necessary to realize a “fresh start.” When a debtor files in bankruptcy, a bankruptcy “estate” is created. In some cases, the law permits the debtor to *exclude* property from the estate altogether; in others, property is included in the estate, but is *exempted* from the reach of creditors.

Although it would be within Congress’ authority to establish a uniform set of bankruptcy exemptions which would be binding upon the states by virtue of the

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<sup>7</sup> Although chapter 11 is clearly designed to facilitate business, i.e., corporate reorganization, an individual consumer debtor not engaged in business is permitted to file. *Toibb v. Radloff*, 501 U.S. 157 (1991). The 1994 Bankruptcy Reform Act amendments significantly raised the permissible debt levels for filing under chapter 13. Hence, many individuals who could not file under chapter 13 and of necessity filed to reorganize under chapter 11, may now avail themselves of chapter 13.

<sup>8</sup> 2 Cowans Bankr. Law and Practice § 8.1 (7<sup>th</sup> ed. 1998).

Supremacy Clause, the Code does not do so.<sup>9</sup> Despite recommendations from the 1970 Bankruptcy Commission advising Congress to adopt a uniform system of national bankruptcy exemptions,<sup>10</sup> Congress declined to do so. Congress permits not just that the debtor make an election between federal and state created exemptions, but permits the states to deny debtors the use of — or “opt out” from — federal exemptions.<sup>11</sup> There is a significant variance between the states in the generosity of their exemptions and more than half have enacted laws that deny debtors the use of federal exemptions.<sup>12</sup>

When the debtor’s state of domicile has *not* enacted legislation which precludes a debtor from electing federal exemptions, the following are available:<sup>13</sup>

- the debtor’s aggregate interest, not to exceed \$18,450, in real or personal property that the debtor uses as a residence, or in a burial plot for the debtor or a dependent;
- the debtor’s interest, not to exceed \$2,950, in a motor vehicle;
- the debtor’s interest, not to exceed \$475, in any one item or \$9,850 in aggregate value, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held for personal or family use of the debtor;
- the debtor’s aggregate interest, not to exceed \$1,225, in jewelry held primarily for the personal use of the debtor;
- the debtor’s aggregate interest in any property, not to exceed \$975, plus up to \$9,250 of any unused amount of the exemption for housing above;
- the debtor’s aggregate interest, not to exceed \$1,850, in any implement, professional books, or tools of the trade of the debtor;

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<sup>9</sup> The U.S. Constitution expressly delegates to the Congress the power “To establish ... uniform Laws on the subject of Bankruptcies throughout the United States.” Article I, section 8, clause 4.

<sup>10</sup> Report of the Commission on Bankruptcy Laws, H.R. Doc. No. 137, Part I, 93<sup>rd</sup> Congress, 1st Session 170-173 (1973).

<sup>11</sup> The opt-out program for exemptions was one of many compromises between the Senate, which advocated retaining exemptions under state law, and the House, which enacted a bill premised on federal exemptions. See Kenneth N. Klee, Legislative History of the Bankruptcy Reform Act of 1978, in 1979 Annual Survey of Bankruptcy Law 21 (Callaghan & Co. 1979).

<sup>12</sup> 2 Cowans, *supra* at § 8.2.

<sup>13</sup> Pursuant to amendments effected by the 1994 Reform Act, monetary amounts for exemptions will be adjusted automatically at three-year intervals to reflect the change in the Consumer Price Index. 11 U.S.C. § 104(b).

- any unmatured life insurance contract owned by the debtor;
- the debtor’s aggregate interest, not to exceed \$9,850, in any accrued dividend under, or loan value of, any unmatured life insurance contract under which the insured is the debtor;
- professionally prescribed health aids;
- the debtor’s right to receive social security benefits, unemployment compensation, public assistance benefits, veterans’ benefits, disability, illness or unemployment benefits, alimony and support to the extent reasonably necessary;
- benefits under certain pension, profit sharing, stock bonuses, annuity or similar plan or contract, to the extent necessary for the support of the debtor;
- the debtor’s right to receive property traceable to an award under a crime victim’s reparation law; a payment on account of a wrongful death of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor; a personal injury award not exceeding \$18,450 for actual compensation (not including pain and suffering); and, payment in compensation for loss of future earnings, to the extent reasonably necessary for support.

In states where federal elections are not permitted, the debtor is limited to his exemptions under applicable state law and nonbankruptcy federal statutes. The amount and value of state law exemptions varies enormously. Among the best-known are those states with homestead exemptions of unlimited monetary value.<sup>14</sup> Media attention is frequently given to wealthy debtors who establish pre-bankruptcy residency in a state with a generous homestead exemption. But what may appear to be anecdotal illustrations of “abuse” are the result of a deliberate congressional decision to permit states to limit their residents to state law exemptions, and of the deliberate statutory policy of various states to permit, for whatever reason, residents to avail themselves of an unlimited homestead exemption.

Another area which leads to great disparity in the treatment of consumer debtors is the disposition of pension funds. In some instances, a debtor’s pension funds may be completely excluded from the bankruptcy estate;<sup>15</sup> in others, they may be exemptible under either the Code’s exemptions<sup>16</sup> or state law. The net result of the complex interaction of these laws is that a debtor’s pension assets — often substantial — may be *excluded*, or some or all of the pensions funds may be *exempted*, from the bankruptcy estate available to satisfy creditor claims. When

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<sup>14</sup> Homestead exemptions in Florida, Iowa, Kansas, South Dakota, Texas, and the District of Columbia are of unlimited monetary value.

<sup>15</sup> 11 U.S.C. § 541(c)(2). *See also* Patterson v. Shumate, 504 U.S. 753 (1992).

<sup>16</sup> 11 U.S.C. § 522(d)(10)(E).



assets are excluded from the estate, they are not administered by the bankruptcy court. When they are exempted, they are beyond creditors' reach. Thus, the fact that debtors emerge from bankruptcy with various amounts of assets intact, though often perceived to be an "abuse" of the law, is often a result of the law's application.

**Voluntary vs. Mandatory Reorganization.** Although a debtor may be forced into chapters 7 or 11 involuntarily by creditors,<sup>17</sup> that is rarely the case. The vast majority of all bankruptcy cases are filed voluntarily by the debtor. Chapter 13 may *only* be entered voluntarily by the debtor.

Chapter 13 was expressly designed to have built-in incentives to encourage debtor filing as an alternative to liquidation under chapter 7. Among those features are the "superdischarge", i.e., the possibility of paying down and ultimately discharging some types of debt that may not be discharged under chapter 7, and the ability to save the debtor's home by permitting him to cure arrearages in a home mortgage where defaults may have occurred and foreclosure proceedings commenced.

Creditors are benefitted by the "best interests of the creditor" confirmation standard, i.e., the requirement that creditors receive more under the debtor's proposed reorganization plan than they would if the debtor were liquidated under chapter 7. Indeed, creditors generally receive greater repayment when the debtor pledges post-petition income to debt repayment than is the case under chapter 7 where only pre-petition assets are dedicated to pre-petition debt satisfaction. That is why creditors have long sought "mandatory" consumer reorganization.

**The "Fresh Start" Policy Implicit in Bankruptcy Law.** The question whether debtors should be compelled to pay creditors from *future* wages is not a new one, although it is central to the legislation currently under consideration. The issue was raised long before the current Code was enacted. Chapter XIII wage earner reorganization was formally introduced into the Bankruptcy Act of 1898 by 1938 amendments effected by the Chandler Act.<sup>18</sup> In 1934, however, the U.S. Supreme Court, in *Local Loan Co. v. Hunt*,<sup>19</sup> had occasion to consider the question whether a bankruptcy debtor's assignment of (future) wages under state law created a lien that was nondischargeable under the federal bankruptcy law. Creditors argued that their claim for future wages created a security interest — a statutory lien — that could not be discharged in bankruptcy. The Court held that an assignment of future wages did *not* create a nondischargeable lien in bankruptcy:

One of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.' ...

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<sup>17</sup> 11 U.S.C. § 303.

<sup>18</sup> 52 Stat. 840 (June 22, 1938).

<sup>19</sup> 292 U.S. 234 (1934).

When a person assigns future wages, he, in effect, pledges his future earning power. The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much if not more than it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern. From the viewpoint of the wage-earner there is little difference between not earning at all and earning wholly for a creditor. Pauperism may be the necessary result of either. The amount of the indebtedness, or the proportion of wages assigned, may here be small, but the principle, once established, will equally apply where both are very great. The new opportunity in life and the clear field for future effort, which it is the purpose of the Bankruptcy Act to afford the emancipated debtor, would be of little value to the wage-earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy. Confining our determination to the case in hand, and leaving prospective liens upon other forms of acquisitions to be dealt with as they may arise, we reject the Illinois decisions as to the effect of an assignment of wages earned after bankruptcy as being destructive of the purpose and spirit of the Bankruptcy Act.<sup>20</sup>

Both the 1970 and the 1994 Bankruptcy Commissions considered and rejected the notion of requiring consumer debtors to devote future income to debt satisfaction as a condition of obtaining relief in bankruptcy.

**1973 Report of the Commission on Bankruptcy Laws.** The Commission which helped lay the foundation for the current Code considered proposals for limiting the bankruptcy relief available to wage earners. The Commission noted that the frequency of utilization of wage earner reorganization, chapter XIII under the Bankruptcy Act of 1898, reflected local legal “culture,” that is, the familiarity of the local bar with and the propensity of attorneys to encourage debtors to file under chapter XIII.<sup>21</sup> In some districts, debtors were advised by attorneys more knowledgeable in implementing reorganization as to its viability, and were encouraged by the court and creditors to reorganize; in others, wage earner reorganization was an unfamiliar, and therefore, nonpreferred procedure.

Nonetheless, the Commission specifically considered and rejected the notion of *requiring* wage earner reorganization:

[P]roposals have been made to Congress from time to time that a debtor able to obtain relief under Chapter XIII should be denied relief in straight bankruptcy, and the Commission has received communications expressing support for a change in the Bankruptcy Act to this effect.

After Congressional hearings in 1967, however, the House Judiciary Committee determined that it should not recommend the enactment of this proposed change in the provisions of the Bankruptcy Act applicable to wage earners. The proposal was opposed by the Judicial Conference of the United States, the National Bankruptcy Conference, the Association of the Bar of the

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<sup>20</sup> *Id.* at 244. Citations omitted.

<sup>21</sup> Report of the Commission on Bankruptcy Laws, *supra* at 157.

City of New York, and spokesmen for labor unions. The measure was supported by the American Bar Association, the American Bankers Association, the Chamber of Commerce of the United States, CUNA International, Inc., the National Federation of Independent Business, and the American Industrial Bankers Association.

The arguments against the proposal included objections made to the difficulties of achieving any nationally uniform standard of application by referees throughout the country, as evidenced by the divergence of their viewpoints regarding the virtues of Chapter XIII. Another view expressed by opponents was that fulfillment of a debtor's commitment made pursuant to a Chapter XIII plan requires not merely a debtor's consent but a positive determination by him and his family to live within the constraints imposed by the plan during its entire term and a will to persevere with the plan to the end. Imposition of a Chapter XIII plan on an unwilling debtor, it was said, would be almost bound to encourage the debtor to change employment and, if necessary, to move to another area to escape the importuning calls and correspondence of his creditors. Likewise, those petitioning debtors turned away by the court on the ground that they failed to show that relief would not be obtainable under Chapter XIII would be motivated to change jobs and locations to get away from creditors who would threaten garnishment and other means of collecting debts. In states where wage garnishment is an unavailable remedy of creditors, the impact of the proposed legislation would have been minimal. A final argument made in opposition to the proposed legislation was that business debtors are not subject to any limitation on the availability of straight bankruptcy relief, including discharge from debts, and it was pointed out that, quite apart from bankruptcy, business debtors are able to incorporate and to limit their liability to their investments in corporate assets. To force unwilling wage earners to devote their future earnings to payment of past debts smacked to some of debt peonage, particularly when business debtors could not be subjected to the same kind of regimen under the Bankruptcy Act.

The Commission has considered the arguments made for conditioning the availability of bankruptcy relief, including discharge, on a showing by the debtor that he cannot obtain adequate relief from his condition of financial distress by proposing a plan for payment of his debts out of his future earnings. The Commission has concluded that forced participation by a debtor in a plan requiring contributions out of future income has so little prospect for success that it should not be adopted as a feature of the bankruptcy system.<sup>22</sup>

Some argue that the Commission's concerns about national uniform standards for implementation of reorganization are outdated. However, its concerns with respect to debtor commitment in a mandatory reorganization, the result of debtor insolvency absent reorganization, and of a perceived inequity between consumer and business debtors, remain relevant to many.

***1997 Report of the National Bankruptcy Review Commission.***

Twenty years of experience with the U.S. Bankruptcy Code did not lead the NBRC to significantly alter the judgment expressed in the 1973 Commission Report. The

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<sup>22</sup> *Id.* at 158-159. (Footnotes omitted.) Cited with approval by the House Judiciary Committee in the legislative history of the 1978 Bankruptcy Reform Act. H.R. Rep. 595, 95<sup>th</sup> Congress, 1<sup>st</sup> Session 120-121 (1977).

NBRC considered proposals from the credit industry advocating some sort of debtor-by-debtor scrutiny before permitting debtors to file for chapter 7.<sup>23</sup> The NBRC, by a 5-4 vote, reaffirmed maintenance of the status quo:<sup>24</sup>

Some witnesses concluded that using a means test to establish Chapter 7 eligibility would fall hardest on families already financially pressed past the breaking point, with little provable benefit. Others expressed their concern that with a completion rate of only 32% for *voluntary* Chapter 13 plans today, forcing unwilling debtors into Chapter 13 would only burden the system, decreasing both the overall repayment to creditors and the successful rehabilitation of debtors. ...In a time of increasing strain on judicial resources, questions also have arisen about the number of judges, clerks, and other staff needed to administer a means test to hundreds of thousands of debtors annually. The credit industry has sought means testing consistently for at least 30 years, but Congress has consistently refused to change the basic structure of the consumer bankruptcy laws.

There is no dispute on one point: bankruptcy should be used only by the needy and not by others. The bankruptcy laws should *never* invite abuse. When Congress charged the Commission with its duties, it cautioned that there was no evidence that the bankruptcy system needed radical reform. It characterized the system as ‘generally satisfactory,’ and directed the Commission to review, improve and update the Code ‘in ways which do not disturb the fundamental tenets and balance of current law.’ The Commission conducted an intensive review of consumer bankruptcy that resulted in a full set of recommendations, but the proposals contemplate no change in the basic structure of consumer bankruptcy. Access to Chapter 7 and to Chapter 13, the central feature of the consumer bankruptcy system for nearly 60 years, should be preserved.<sup>25</sup>

In summary, the two Bankruptcy Commissions charged with considering the prospect of mandatory consumer reorganization cited the following reasons in support of their rejection of the concept:

- difficulty of compliance by unwilling/unable debtors. Subjecting those, for whatever reasons, least able to manage finances to an extremely strict long-term future budget is likely to fail;
- current low success rate for voluntary reorganization;
- difficulty of creditor collection where debtors avoid bankruptcy relief to evade mandatory reorganization;
- no comparable business requirement;

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<sup>23</sup> NBRC Final Report, *supra* at 89 (“The consumer bankruptcy debates never lacked a discussion of whether debtors are receiving ‘more relief than they need,’ although the cost and implementation of a ‘means testing’ system were not developed in specific detail.”).

<sup>24</sup> None of the four dissenting commissioners appears to specifically advocate “means testing” as a consumer bankruptcy reform. They do, however, “disagree most strongly with the [Commission] Framework proposals that . . .discourage Chapter 13 repayment plans and encourage Chapter 7 liquidations[.]” Dissent, *supra* at 3.

<sup>25</sup> *Id.* at 90-91 (footnotes omitted; emphasis in original).

- increased implementation costs.

Congress had also considered and rejected the idea.<sup>26</sup>

## Legislative Goals of Consumer Reform

The high volume of consumer bankruptcy filings during the 1990's fueled the argument that the current law is too lenient, i.e., "debtor-friendly." Proponents of consumer bankruptcy reform cite many reasons for their support. The legislation is intended, among other things, to make filing more difficult and thereby thwart "bankruptcies of convenience"; to revive the social "stigma" of a bankruptcy filing; to prevent bankruptcy from being utilized as a financial planning tool; to determine who can pay their indebtedness and to ensure that they do; to lower consumer credit interest rates; and, to maximize the distribution to both secured and unsecured creditors. To effect these goals, the proposals implement a "means test" to determine consumer debtors' eligibility to file under chapter 7.

Opponents argue that making it more difficult to file will undermine the rehabilitative purpose of bankruptcy and have a disparate impact on financially less sophisticated debtors. They believe that there is insufficient evidence of pervasive abuse to warrant major revisions to bankruptcy law and that consumer filings continue to be the result of uncontrollable factors such as job loss, catastrophic medical bills, and/or divorce. Studies from early in the reform legislation's consideration attempted to estimate the increase in creditor recovery that would come about as a result of means testing, but a review of the studies concluded that they were hypothetically-based and generally inconclusive.<sup>27</sup>

## Legislative Issues Surrounding Consumer Bankruptcy Reform

***The Homestead Exemption.*** Throughout consideration of bankruptcy reform, there has been tension between proponents of states rights realized through the opt out system and those who view the disparities it creates as degrading the uniformity and equity of a national bankruptcy system.

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<sup>26</sup> See, e.g., *Oversight Hearing on Personal Bankruptcy Before the House Judiciary Subcomm. on Monopolies and Commercial Law*, 97<sup>th</sup> Congress, 2d Session (1982); "Bankruptcy Reform Act of 1978 (Future Earnings), Part 2," *Hearings Before the Senate Judiciary Subcomm. on Courts*, 97<sup>th</sup> Congress, 1<sup>st</sup> Session (1981); *Hearing on H.R. 1057 and H.R. 5771 Before Subcomm. No. 4 of the House Comm. on the Judiciary*, 90<sup>th</sup> Congress, 1<sup>st</sup> Session (1967).

<sup>27</sup> General Accounting Office, *Personal Bankruptcy: Analysis of Four Reports on Chapter 7 Debtors' Ability to Pay*, GAO/GGD99-103 (June 1999).

The breadth of the homestead exemption in a state with an unlimited one was articulated in *Havoco of America v. Hill*.<sup>28</sup> The Supreme Court of Florida, responding to a certified question from the Eleventh Circuit Court of Appeals, held that a debtor who converts nonexempt assets into an exempt homestead with the specific intent to hinder, delay, or defraud creditors is nevertheless a qualified beneficiary of the state homestead exemption. The court explained that the State Constitution recognizes only *three* exceptions to the exemption: payment of taxes on the property; contractual obligations for the purchase, improvement or repair of the property; and, contractual obligations for house, field or other labor performed on the realty. Nor could Florida's fraudulent conveyance law expand or limit the scope of the homestead exemption.

The court was "loathe" to provide constitutional sanction to the debtor's use of the exemption to shield his assets from creditors, but viewed the state constitutional provision as "unqualified:"

These [constitutional] exceptions are unqualified. They create no personal qualification touching the moral character of the resident nor do they undertake to exclude the vicious, the criminal, or the immoral from the benefits so provided. The law provides for punishment of persons convicted of illegal acts, but this forfeiture of homestead rights guaranteed by our Constitution is not part of the punishment.<sup>29</sup>

Conflicting views on an appropriate homestead exemption have been a prime subject of debate in connection with reform proposals. Although earlier versions of Senate-passed legislation imposed a firm cap on exemptible home equity, such provisions have generally been omitted from final versions of the legislation.<sup>30</sup> The preferred solution is to attempt to dissuade potential debtors from venue-shopping by imposing homestead caps on a resident/debtor who has moved to take advantage of a generous homestead exemption. Most versions of the bill, however, allow a debtor to exempt up to one million dollars in pension assets. Pension amendments attempt to clarify and standardize the current hodgepodge of state and federal laws covering protectible pension assets. Hence, consumer reform would still permit debtors potentially to exempt millions of dollars from their bankruptcy estates. Although this scenario is rare, it is consistent with current law. Critics of the legislation — many of whom may be critics of the current opt out system — argue that it would be even more inappropriate in light of means testing. The means test formula would be implemented to block access to chapter 7 to debtors of average means and/or to require them to undertake chapter 13 reorganization plans that require them to live on a budget based on Internal Revenue Service national and local living standards for three to five years. Imposing strict new standards on asset-poor wage earners while permitting asset-rich ones to continue to shelter wealth in bankruptcy remained controversial.

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<sup>28</sup> 790 So.2d 1018 (Fla. 2001).

<sup>29</sup> *Id.* at 1022.

<sup>30</sup> See, e.g., H.Rept. 107-617, 107<sup>th</sup> Cong., 2d Sess. (2002), the Conference Report to H.R. 333, 107<sup>th</sup> Cong., 2d Sess. (2002).

***Nondischargeability for liability incurred in connection with violence at reproductive health clinics.*** On the same day that the Senate passed its version of reform legislation in the 106<sup>th</sup> Congress, it adopted an amendment sponsored by Senator Schumer to prevent the discharge in bankruptcy of liability incurred as a result of violence at abortion clinics.<sup>31</sup> Floor debate at the adoption of this amendment makes clear that its proponents sought to ensure that civil liability arising from disruption of and violence against abortion service providers or consumers could not be discharged in a bankruptcy proceeding.<sup>32</sup> Opponents of the provision argued, among other things, that the provision was unnecessary<sup>33</sup> and that its language was overly broad.<sup>34</sup>

Critics argued that the provision is unnecessary in light of the Freedom of Access to Clinic Entrances Act (FACE), 18 U.S.C. § 248, the primary federal law addressing violence at reproductive health clinics. FACE provides both criminal penalties and civil liability for anyone who *intentionally* interferes with or injures someone attempting to access a reproductive health facility or causes damage to the facility itself. The Code, at 11 U.S.C. § 523(a)(6), prohibits discharge of debts “for willful and malicious injury by the debtor to another entity or to the property of another entity[.]” Many believe that FACE and 11 U.S.C. § 523(a)(6) operate sufficiently in tandem to prevent bankruptcy discharge of liability for abortion clinic violence. Furthermore, there is scant reported case law sanctioning discharge of this kind of debt. But every individual’s bankruptcy does not lead to a reported decision. Senator Schumer gave several examples of individuals who filed in bankruptcy to avoid payment<sup>35</sup> of judgments for anti-abortion related violence.<sup>35</sup>

Proponents countered that the language of the expanded nondischargeability provision was deliberately broader than the above-cited statutes and would encompass a wider array of federal, state, or local laws designed to protect access to health care facilities. The activities that could be the source for nondischargeable

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<sup>31</sup> 146 CONG. REC. S247 (daily ed. Feb. 2, 2000). H.R. 833 (S. 625), 106<sup>th</sup> Cong., 2d Sess. (2000), as passed by the Senate, § 328.

<sup>32</sup> *See, e.g.*, 146 CONG. REC. S231 (“It is wrong to allow court judgments under the Freedom of Access to Clinic Entrances Act to be discharged under our bankruptcy laws. In fact, 12 individuals who created the Nuremberg Files website filed bankruptcy to avoid their debts under the law.”) (statement of Sen. Leahy); (“[T]his is an extremely important amendment to keep a bipartisan law, the FACE law, alive and well. If we don’t pass this amendment, there will be hundreds and hundreds of instances where people violate the FACE law, and they will not be held accountable.”)(statement of Sen. Schumer).

<sup>33</sup> *See* 146 CONG. REC. S229 (This amendment is unnecessary ... Not only is it poor policy to segregate certain classes of violence for special status in bankruptcy, but the bankruptcy code already allows for the nondischargeability of debts for ‘willful and malicious injury by the debtor.’”)(statement of Sen. Hatch).

<sup>34</sup> *Id.* (statement of Sen. Hatch) (“I urge my colleagues to read the actual text of the amendment before they vote. If they believe they are voting on an amendment that strictly covers act of violence at abortion clinics, they are mistaken. Who knows how this amendment is going to be applied otherwise.”).

<sup>35</sup> 146 CONG. REC. S226-7 (statement of Sen. Schumer).

liability under the proposed amendment need not have a specific intent requirement as required by 11 U.S.C. § 523(a)(6). And the existence of the requisite intent need not be litigated, making it easier for victims who are judgment-creditors to protect the nondischargeable status of their claim.

During the 107<sup>th</sup> Congress, language in the Senate bill addressing the issue was broadened and restyled as “Nondischargeability of Debts Incurred Through Violations of Laws Relating to the Provision of Lawful Goods and Services.”<sup>36</sup> The version passed by the House did not have a comparable provision. The Schumer Amendment in the Senate bill provided the basis for a House-Senate compromise. Extensive negotiations took place under the leadership of Senator Schumer and Representative Hyde. It was reported in the press that the conference had reached agreement on the entire bill, but for the Schumer Amendment. Representative Hyde and Senator Schumer apparently agreed that anti-abortion protesters should not be able to file for bankruptcy to escape fines and civil penalties for acts or threats of violence. But they disagreed on the extent to which protesters who file for bankruptcy should be compelled to pay judgments for non-violent acts of protest. Nevertheless, a compromise was reached, and the bill was reported out of conference. As in the Senate bill, reference in the Conference Report was made to “laws relating to the provision of lawful goods and services.”

Subsequent to the filing of the Conference Report, renewed opposition to the Schumer Amendment arose. The concerns expressed were those which followed the provision throughout the 107<sup>th</sup> Congress — namely, its scope and the extent to which the language encompasses nonviolent protest. In addition, several unions weighed in against the measure, saying it would have a chilling effect on labor, civil rights and environmental demonstrators.

***Protection of child support.*** Throughout the debate over bankruptcy reform, concern has been expressed about the impact of the proposed changes in consumer bankruptcy on the ability of debtors as parents to meet and maintain child and family support obligations.

Previous versions of the legislation make domestic support obligations a top priority. Yet, some women’s and consumer groups criticized the legislation because of the adverse impact they believe it would have on debtors’ ability to pay support. This criticism is not generally directed at the status of support payments *within* bankruptcy. To the extent that any creditor gets paid in bankruptcy, child support creditors are likely recipients. And, child support is nondischargeable. The concern is directed to competing claims for payment in two situations. First, if or when a debtor does *not* file, because he is ineligible for chapter 7 — and won’t undertake or can’t complete a reorganization plan. Second, when a debtor receives a bankruptcy discharge, there will be, under the reform legislation, many new classes of nondischargeable debt that may compete for payment along with family support (including money owed by the debtor to government agencies for support). Several of the new categories of nondischargeable debt are various types of credit card debt.

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<sup>36</sup> S. 420, 107<sup>th</sup> Cong., 1<sup>st</sup> Sess. § 329 (2001).



The legislation's supporters counter that child support payments are favored under federal and state law. There are federal and state programs to collect payment of child support.<sup>37</sup> But outside of a bankruptcy court, there is no single forum where an individual's debts are assembled and assigned priority of payment. Debt collection outside of bankruptcy is fact-specific and may depend on many variables, including an individual's intent with respect to debt repayment and the creditor's resources to pursue debt collection.

***Linking bankruptcy treatment of credit card debt to credit lending practices.*** Many of the provisions of bankruptcy reform legislation would significantly enhance the status of credit card lenders in a consumer bankruptcy. More categories of credit card debt would become nondischargeable and creditors in general would play a greater role in the bankruptcy. Although it is difficult to determine the precise relationship between increases in consumer credit and increased consumer bankruptcy filings,<sup>38</sup> many believe that there is a connection between aggressive credit marketing, debt burdens, and bankruptcy filings.

To address the perceived "linkage" between credit marketing and failure of credit management, i.e. bankruptcy, many proponents and opponents of reform insisted upon measures to enhance consumer education about the consequences of credit card usage. Both the House and Senate versions in the 106<sup>th</sup> Congress had provisions requiring studies by the Board of Governors of the Federal Reserve and amendments to the Truth in Lending Act (TILA), 15 U.S.C. § 1637, requiring informational disclosures in connection with credit card advertising and billing statements. Some combination of study and disclosure requirements have been a fixture in subsequent legislation.

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<sup>37</sup> See CRS Report 97-408, *Child Support Enforcement: New Reforms and Potential Issues*, by Carmen Solomon-Fears.

<sup>38</sup> See CRS Report 98-277, *Bankruptcy and Credit Card Debt: Is There a Causal Relationship?* by Mark Jickling.