

# Understanding the New Bankruptcy Laws



By Amy Buttell Crane • Bankrate.com

Being broke is getting tougher. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, designed to curb abusive consumer bankruptcy filings, affects anyone who files for bankruptcy beginning Oct. 17.

While there are a few bright spots in the law, the overall picture is pretty dim for consumers deeply in debt.

A wide range of provisions will force consumers into lengthy, expensive proceedings potholed with potential pitfalls. Miss one filing deadline and your bankruptcy could be dismissed, leaving you facing a series of escalating penalties when you refile that will make it that much harder to get back on your feet, financially.

And that's not the worst part. A complicated means test, administered by your own attorney, will determine whether you'll be allowed to file under the more-forgiving Chapter 7 or a Chapter 13 proceeding.

In addition, your collateral, including furniture, cars and other possessions, will be assessed at a higher value, inflating the overall value of your assets.

When you're worth more, your creditors can potentially get more out of you. It will also be harder to get out from under car loans, overdue taxes, student loans and credit card debt.

While cracking down on deadbeats who abuse the system isn't going to leave anyone reaching for the tissue box, many of those who file for bankruptcy are pushed to the edge by unemployment and catastrophic health problems.

"There are dozens of catches [in the law] that will make it difficult for people who legitimately need to file for bankruptcy," says Travis Plunkett, legislative director for the Consumer Federation of America. "The strategy of the people who supported this bill appears to be death by a thousand cuts. There are lot of traps and gotchas designed to snare people and keep them from discharging debt that they really may need to get out from under."

## Pre-filing changes

**Means test.** The means test is a major change in the law. It is used to determine whether an individual can file under Chapter 7 or Chapter 13 and is administered by the client's attorney. Chapter 7 generally liquidates the debts of consumers, while Chapter 13 requires them to pay back their secured debt and as much of their unsecured debt as possible.

Here is an overview of the means test:

- **Income:** Using your state's median income, your attorney determines whether your income, determined by averaging those of the past six months, is above or below that median. That figure must be used even if it is no longer accurate; that is, if the consumer has lost his or her job, or now makes less money.
- **Expenses:** After excluding mortgage or rent payments, car payments, past due taxes and child support, and \$1,500 in private school tuition, your attorney figures out whether the you can still pay \$100 a month, or more, over the next five years to your unsecured creditors. Those expenses are based on IRS norms for such expenses, which may be way below what your expenses actually are.
- **Bottom line:** If your income is above the state median income, you must file under Chapter 13 instead of Chapter 7, unless the bankruptcy court rules that your circumstances are extraordinary. Even if you pass the first part of the means test and have an income lower than your state's median, if you can pay more than \$100 a month of your unsecured debt over the next five years you have to file Chapter 13 -- unless the court rules that your circumstances are extraordinary.

"People like me and others raised a lot of questions about the means test while this bill was under consideration," says Plunkett. "It is very complicated and very restrictive. It could keep middle-class families, who have suffered legitimate financial difficulties, who have slightly higher income than what is allowed, out of Chapter 7."

Howard Ehrenberg, a partner in the law firm SulmeyerKupetz in Los Angeles and a member of the Chapter 7 Bankruptcy Panel of Trustees, believes that many judges will use their discretion to allow debtors to file under Chapter 7 using these extraordinary provisions.

"We're going to have to see how all this plays out over the next few years," he says. "It will still be up to the judge to decide if abuse exists, and the judge will be able to consider whether extraordinary circumstances exist."

**Residency requirements.** Bankruptcy laws exist at both the state and federal level, and some states' laws are more favorable than both other states' and federal law. The new law is designed to prevent debtors from "jurisdiction shopping" to find the state with the most favorable laws, moving there and immediately filing bankruptcy.

"The law is designed to keep people out of states, like Florida, that are more favorable to the consumer," says Robert Geller, an attorney with Robert M. Geller & Associates in Tampa, Fla. If you're living in a state for less than two years that has more favorable provisions than the one you previously lived in, you can't use the more favorable provisions.

**Collateral valuation.** Your personal possessions, including furniture, clothes and electronics, will now be assessed at a higher value than were previously assessed. The law mandates that these possessions, known as collateral, be assessed at their replacement value, taking age and condition into consideration.

"Before this law, I would tell my clients to make a list of their stuff and the price it would get at a garage sale," says Tim Duggan, chair of the Bankruptcy and Creditors' Right Group at Stark and Stark, a law firm in Lawrenceville, N.J. "Now, you have to figure out what your TV and couch are worth. With cars, that is easy, just go to sites like Edmonds.com. But now, the client has to come up with replacement values and the attorney has to certify that these are correct. How do you do that without a professional appraiser?"

"The effect of this is that when your collateral is worth more, that puts a higher value on your assets in the bankruptcy petition, which could ultimately result in you making higher payments to your unsecured creditors."

### **Increased paperwork and expense load**

**Paperwork overview.** The burden on the consumer to document income and expenses has vastly increased under the new law. According to the American Bankruptcy Institute, consumers must provide:

- A list of all creditors, secured and unsecured.
- Schedules of assets and liabilities.
- Schedules of income and expenses.
- Certificate of credit counseling.
- Evidence of payment from employers, including pay stubs of the past 60 days.
- Statement of monthly net income.
- Tax returns for the most-recent tax year.
- Tax returns for several years prior to the filing, if those returns hadn't previously been filed with the IRS.
- Photo identification.

If these documents aren't provided to the bankruptcy court within 45 days of the initial filing, the court will automatically dismiss the case. You can file for one 45-day extension, which may or may not be granted.

**Legal costs.** John Penn, president of the American Bankruptcy Institute and a partner with the law firm Haynes and Boone in Fort Worth, Texas, estimates that legal costs involved in a bankruptcy filing will double once the new law goes into effect.

"The main reason it will be more expensive is there is so much more work required of lawyers and debtors," he says. While there is no set fee for these cases throughout the country, typical fees currently range from \$750 to \$1,500, he says. Doubling those fees drives up the cost to between \$1,500 and \$3,000.

Besides increased costs, lawyers will labor under increased burdens. They will be required to certify that their client's claims in terms of assets, liabilities, income and expenses are accurate and could face court sanctions if they aren't.

Lawyers are also placed in the odd position of being unable to advise their clients to take on new debt before they file for bankruptcy, including the debt of legal fees. "You can't advise your client to incur additional debt, but paying the lawyer will result in more debt," says Ehrenberg. "You have violated the code if you have encouraged them to incur an additional debt, whether that is legal fees or other costs, even if that is the best advice you can offer."

### **Refiling and serial filings**

**Refiling.** If your bankruptcy case is dismissed for any reason and you still can't pay your bills, you'll have to refile. Before Oct. 17, this isn't much of an issue because completing a case is much easier and there aren't penalties for refiling. But that is changing.

"There are provisions in the law that sharply limit relief if you are filing after a prior case has been dismissed," says Penn. "You will probably see people who try to do it themselves end up having their case dismissed, and by the time they come back for round two the terms won't be as good."

When a bankruptcy case is filed, the court automatically stops the collection efforts of debtors' creditors. This includes both secured and unsecured creditors. Secured creditors are those with loans secured by property such as a home, car, boat or furniture. Unsecured creditors are those that don't have any interest in property and include credit card companies.

However, this stay isn't automatic if you previously filed a bankruptcy case that was dismissed. Under the new law, such refilings are automatically treated as abusive, even if the prior case was dismissed because you weren't aware that you had to file certain documents or you made a mistake.

You'll have to ask the court for a stay within 30 days of your second filing. If the court finds that this filing was made in good faith, you'll get the stay on creditors. If not, you won't, and your house or other property could be repossessed despite the fact that you are in bankruptcy. If it is your third time around, the stay is even more difficult to get.

**Serial filers.** While the old law forced consumers to wait a certain period of time between bankruptcy filings, it was much easier to file for one type of bankruptcy after filing for another. For example, in legal circles, consumers who file a Chapter 13 to hold on to their secured property and then file a Chapter 7 to get out from under debts held over under the Chapter 13 are known as "Chapter 20" filings.

"A lot of Chapter 13 filings fail because the debtor either can't or won't pay his creditors under the plan worked out in that filing," says Howard Dvorkin, president of Consolidated Credit Counseling Services, a consumer credit counseling agency in Fort Lauderdale, Fla. "So they end up with what we call a Chapter 20."

The new law lengthens the amount of time between Chapter 7 filings to eight years, there must be four years between a Chapter 7 and a Chapter 13, and two years between consecutive Chapter 13s, according to the American Institute of Bankruptcy.

### **The bright spot**

**Reducing unsecured claims.** The biggest bright spot in this law allows bankruptcy courts to impose debt reductions of up to 20 percent on unsecured creditors who don't cooperate with consumer credit counseling agencies' efforts to negotiate payment plans with those creditors. While many creditors are usually willing to reduce interest rates in repayment plans, few offer any reduction of principle. This provision gives consumers and consumer credit counseling agencies some real leverage in negotiating, says Plunkett.

In many cases, unsecured creditors are the credit card companies who were a driving force behind this bill. And while credit card companies ultimately stand to recoup more from consumers in bankruptcy, this provision will actually let consumers do something meaningful to reduce their overall debt load into a more payable amount.

A court can force this 20-percent reduction of principal on unsecured creditors if they refuse an offer from a debtor through a consumer credit counseling agency, offering to pay 60 percent of the debt due if the plan is proposed within 60 days of filing a bankruptcy petition.

**Enhanced disclosures.** For debtors who sign agreements with creditors to continue paying back debt during and after bankruptcy, known as reaffirmation, the law specifies that these consumers must be fully informed of their rights and the exact terms of these agreements. Consumers have the right to change their minds within a certain period of time and receive documents stating the date payments are to begin, as well as the interest rate to be paid.

**Retirement and college savings gain protection.** If a consumer entering bankruptcy has funds in a retirement plan such as a 401(k), 403(b) or an IRA, those funds aren't included in the bankruptcy as an asset available to creditors. College savings accounts for children are also exempt, and debtors are allowed to continue to fund retirement plans, if they can.

"IRAs, other retirement plans and 529s are exempt; so, the law is trying to protect consumers' retirement benefits, which is very good," says Duggan. "But in most cases there is not a lot to protect in the first place."

**Support obligations.** Child support obligations now receive top priority in bankruptcies, ahead of all other unsecured claims except administrative and legal fees. Debtors in Chapter 13 must pay back all child support arrears before their bankruptcy can be completed or discharged.