

This is the twenty-third in my series of newsletters. Due to your great interest, I plan to continue this quarterly report for my clients.

## **THE TRUTH ABOUT BANKRUPTCY REFORM**

Too many of my clients do not seem to realize the implications of what Congress is attempting to do in reforming the current bankruptcy law. These are not just some minor adjustments but **DRASTIC CHANGES** that will have far reaching implications for any person who is hit with hard times and needs bankruptcy protection.

On May 5 1999, the House of Representatives passed H.R. 833 by a vote of 313 to 108. Similarly on February 2 2000, the Senate passed a substitute version of the House bill by a vote of 83-14. Now both bills are currently in conference committee and if and when the House and Senate reconcile the differences a new bankruptcy law will most likely be signed by President Clinton. Based on the initial votes, the House and Senate could probably override any presidential veto.

Since the bills are over 400 pages, I seek to highlight the **DRASTIC CHANGES**.

### **I. MEANS TESTING**

A. House: This amends section 707 to create a rebuttable presumption of abuse for Chapter 7 if a debtor has more that \$6,000 in disposable income over the next 5 years. There would be a thorough budget examination of expenses, subtracting administrative expenses, attorney fees and living expenses, using the Internal Revenue Services guideline. Also they subtract payments on secured and priority debts over a 60-month period without regard to actual repayment periods. Other expenses must show "extraordinary circumstances."

B. Senate: This also amends Section 707 to create a rebuttable presumption of abuse in Chapter 7 if the debtor can pay the lesser of 25% of unsecured claims or \$15,000 over 60 months. The same expenses are deducted as the House version but additional expenses are allowable on a showing of "special circumstances". Secured and priority debts are stretched over 5 years and there is no exclusion for administrative expenses. The Senate bill also allows deductions for elderly and chronically ill members of immediate family who are not dependents of the debtor.

### **II. INCOME**

A. House: This version is the average income of over the past 180 days but doesn't include Social Security or payments to victims of war crimes or crimes against humanity.

B. Senate: This includes average income of all income over the last 180 days, whether or not taxable, but excludes social security.

### III. MEANS TEST SAFE HARBOR

A. House: This bars parties from bringing motions if the income of the debtor and debtor's spouse is less than the regional household income of a household of equal size.

B. Senate: This bars creditors, but not the Judge, US trustee or panel trustee, from bringing 707(b) motions, if income of debtor and spouse is not greater than both the national and state median family income of a comparable family size.

### IV. SANCTIONS AGAINST DEBTOR'S ATTORNEY

A. House: If a Chapter 7 violates rule 9011, (which requires attorney for debtor to certify the accuracy of the information), then the Court shall assess damage against debtor's attorney.

B. Senate: If a motion to dismiss or convert is granted, the Court shall order debtor's attorney to pay attorney fees if the filing of the Chapter 7 was frivolous. If the debtor's attorney violated Rule 9011, then the debtor's attorney shall pay a penalty to the panel trustee or US trustee.

### V. PRE-BANKRUPTCY DEBT COUNSELING

A. House: As a condition to be eligible to file bankruptcy a debtor must have received credit counseling during 90 days prior to filing unless US trustee finds counseling is not reasonably available in the district. If there are exigent circumstance, you can file but you must obtain counseling within 30 days after the commencement of the case.

B. Senate: In order to file, you must have received credit counseling within 180 days prior to filing unless US trustee finds Non-Profit credit counseling is not reasonably available. One can file without counseling upon a showing of exigent circumstances making counseling unavailable in the five days prior to the commencement of the case. However, the debtor must obtain counseling within 30 days unless the Court grants additional 15 days.

### VI. POST BANKRUPTCY FINANCIAL MANAGEMENT INSTRUCTIONS

A. House: A Chapter 7 and 13 discharge are conditioned on debtor's completion of financial management instruction course unless US trustee finds that course is not reasonably available to debtor.

B. Senate: These provisions are identical.

### VII. SERIAL FILINGS – AFFECT ON AUTOMATIC STAY

House & Senate have identical provisions: The automatic stay would terminate 30 days after the commencement of an individual's case if the case was commenced within one year of the dismissal of a previous case. The Court can extend the bankruptcy Stay if it finds the new case is filed in good faith.

The bill provides that a case is presumptively not in good faith if the following conditions apply:

- 1) There were 2 or more cases pending within the last year.
- 2) Any case pending in the last year was dismissed for the following:
  - a). Failure to file or amend documents;
  - b). Failure to provide adequate protection;
  - c). Failure to perform the terms of a confirmed plan; or  
THERE WAS NO SUBSTANTIAL CHANGE IN THE  
DEBTOR'S FINANCIAL OR PERSONAL AFFAIRS TO  
COMPLETE THE CURRENT CASE.

A debtor can overcome this rebuttable presumption if he can show good faith by clear and convincing evidence.

#### VIII. SERIAL FILINGS – STAY AS TO SPECIFIC CREDITORS

This is the same for the House and Senate bill: If a debtor's last case was dismissed within one year, the bankruptcy Stay ends 30 days after the new filing for any creditor who had Stay relief granted or pending in the prior case.

#### IX SECTION 521 OBLIGATION

Both the Senate and House bills are the same, and substantially expand the debtor's obligations to the trustee.

The debtor must file a certificate of an attorney or petition preparer, that he received notice of alternative forms of bankruptcy relief and availability of credit counseling, plus copies of the past 3 years tax returns, and pay stubs for the past 60 days prior to filing, and a statement of reasonably anticipated income or expenses for the next 12 months.

Debtors in Chapter 7 or 13 must continuously file tax returns while the case is pending. Chapter 13 debtors must file annual income and expense reports while the case is pending.

#### X DISCHARGABILITY CATEGORIES

A House: There is a new provision under section 523 (a)(19) which would provide that loans made to debtors by pension, profit sharing or thrift savings within 1 year prior to filing are not dischargeable.

Also section 523 (a)(2)(c) defines luxury goods nondischargeable. If there was \$250 for the purchase of luxury goods or from the extension of open end credit incurred within the 90 days of filing a bankruptcy.

B. Senate: The Senate has the same bill as the House regarding section 523 (a)(19). However, the amendment to 523 (a)(2)(c) differs from the house bill that the cash advance period is 70 days compared to 90 days and the amount of the cash advance is \$750 compared to \$250.

## XI CRAMDOWN

This is another drastic change to the current law.

A. House: Any purchase money security interest, such as a car loan, furniture loan etc., is fully secured for 5 years from the date of purchase.

B. Senate: Section 1325 is amended to provide that section 506 doesn't apply to any secured loan by a motor vehicle if it was made less than 5 years prior to the filing of the bankruptcy. In other words, if you bought your vehicle in 1996 and today it is worth less than you owe on it, you must pay the value of the secured debt; you cannot pay the fair market value.

Any loan taken out within 6 months of filing is also considered fully secured.

## XII ADEQUATE PROTECTION PAYMENTS.

A. House: This adds a new provision, section 1307a. If you provide a payoff of a vehicle in your plan, you still must in addition to trustee payments, make normal monthly payments on your vehicle, lessors of personal property, or all creditors with security interests not later than 30 days of filing the case.

These payments must continue until the creditor gets payments from the chapter 13 trustee or the debtor surrenders the property. Also, if a creditor repossesses your collateral before you file, the creditor keeps the collateral until the debtor makes the adequate protection payments. Also, proof of insurance is required.

B. Senate: The Senate bill requires the debtor to pay the trustee 30 days after the plan is filed or within 30 days after the case is filed. However, the trustee is required to make adequate protection payments to the creditor not later than 40 days after filing of the case.

## XII HOME MORTGAGE CRAMDOWN

Both the House and Senate bills prohibit cramdown of home mortgages if the debt is secured primarily by the debtor's principal residence.

## XIII TAX RETURNS

A. House: Debtors in Chapter 7 and 13 must file with the Court all returns that are filed during the last 3 years.

B. Senate: Individual debtors in Chapter 7, 11 and 13 must file with the Court tax returns for the last 3 years only if requested by a party in interest. Chapter 13 debtors must file tax returns for the last 4 years with taxing authorities in order to confirm the plan.

## XIV DISCHARGABILITY OF DEBTS

A. Senate: The Senate bill would eliminate many of the super discharge provisions that formally applied to chapter 13. Thus, in chapter 13 any debts incurred for fraud, embezzlement, larceny or fiduciary defalcation, unscheduled claims, fines, penalties and forfeitures, and willful and malicious injury, are no longer dischargeable in chapter 13.

B. House: This is substantially similar to the Senate bill, but is even broader on tax obligations.

See Southeastern Bankruptcy Law Institute, Inc. 26<sup>th</sup> Annual Seminar on Bankruptcy Law & Rules, March 23-25, 2000, Bankruptcy Legislation; and West Group, Bankruptcy Law Letter, April 2000, Vol. 20, No. 4.

These are not minor changes. They are **drastic** overhauls of the present system which will seriously hurt people with financial problems. PLEASE READ THE ARTICLE IN THE MAY 15, 2000 TIME MAGAZINE.

I **urge** you to write your Congressman and Senators since they just don't understand that most people only use this as a last resort after considering all other options. If you don't contact your legislators, there may no longer be any safe haven if creditors are trying to take away your homes and other property which you have worked so hard for.

### **THIRD CIRCUIT ALLOWS CRAM DOWN OF UNDERSECURED MORTGAGES**

In previous newsletters I advised you that you could only cram down a junior mortgage only if the mortgage company took additional collateral such as doors, windows, etc.

However, the Third Circuit Court of Appeals in In Re McDonald, held 205 F 3d 606 (3d cir 2000) that the antimodification clause in 11 USC 1322 (b)(2) done not apply to a second or junior mortgage if the mortgage is wholly unsecured by any remaining value in the residence.

In McDonald, the value of the home was \$126,400 and the balance on the first mortgage was \$127,633.33 and the balance on the second mortgage was \$4,6846.42.

In it's analysis the Third circuit looked at 11 USC 506(a) and 11 USC 1322 (b), which provides that a Chapter 13 Plan may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real estate that is the debtor's principal residence."

In reviewing Nobleman v American Savings Bank, 508 US 324, 113 S. CT 2106 (1993), the Third Circuit reconciled the Nobleman by stating that the antimodification clause of 11 USC 1322 (d)(2) uses "claim" rather than secured claim and applies to both secured and unsecured parts of a mortgage; however the anitmodification language still states that the claim must be "secured only by a security interest, in ... the debtor's principal residence." Thus, if a mortgage is wholly unsecured then the junior mortgage has a wholly unsecured claim and the antimodification clause would not apply 205 F 3d at 612..

Based on this analysis, in a case like McDonald where there is absolutely no equity in the second mortgage, you can cram down the second or junior mortgage.

The last issue is that in order to cram down the second or junior mortgage, you may have to bring expert testimony to establish valuation since if there is one dollar in value, you would lose in cramming down the junior mortgage.

If your home is totally encumbered and your home is totally undersecured feel free to contact me. PLEASE NOT THE HOUSE AND SENATE BILLS SEEK TO ELIMINATE CRAM DOWNS.

## **PENSION LOANS AND BANKRUPTCY**

Many of my clients who file Chapter 13 attempt to discharge all their general unsecured debts but have a pension loan deducted from their paycheck bi-monthly.

After they appear at the creditors meeting they get an objection from the trustee that it is improper to allow the pension loan deduction and the trustee wants this added back into their disposable income.

The Third Circuit Court of Appeals in In re Ames, 195 F. 3d 177 (3<sup>rd</sup> Cir. 1999) held that it is improper for a debtor to use his disposable income for repayment of respective retirement systems without full satisfaction of other unsecured. 195 F.3d at 181

In its analysis, the Court looked to 11 USC 1325 (b)(1)B which requires that "The plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date the first payment is due under the plan will be applied to make payments under the plan."

The Court concluded that disposable income is income not reasonably necessary to be expended for the maintenance or support of the debtor or dependant." Id. at 180. Since voluntary contributions are not reasonably necessary for the maintenance or support, they must be made from disposable income. Id. at 181. Thus, since the debtors have used their disposable income for repayment of their respective retirement plans without full satisfaction of unsecured creditors, the plan was rejected under section 1325 (b)(1)(B). Id.

In addition, the Third Circuit rejected the debtors' contention that the doctrine of recoupment applied and refused to allow pension plans to deduct loan payments from their paychecks postpetition. Id. at 181-182.

Finally, the Court also held that pension plans could not make postpetition deductions of loan payments from debtors' paychecks on the ground of setoff. Id. at 183.

What does this mean? If you have a pension loan coming out of your paycheck the trustee will add this into your disposable income and you will have to use that payment towards unsecured creditor.

If you have any questions concerning this matter, always feel free to contact me.

## **LET ME ANSWER ALL YOUR QUESTIONS**

As my law practice continues to grow, I hope to help you in all areas of the law where I have helped my other clients. Remember, even if I am not familiar with a specific area of the law, I work with other lawyers who are well qualified to handle these matters. Therefore, if you have any question on any legal matter whatsoever, please ask me about it.

## **IF YOU LIKE MY WORK, SPREAD THE WORD.**

I appreciate the confidence my clients show by referring new business to me. Such referrals are my largest and best source of new clients. Please let me know if you have a friend or relative who needs legal assistance or who would like to receive one of my quarterly newsletters.

I sincerely appreciate all the referrals from so many of you over the past several years. Thank you for your continued confidence and good will.

If you would like me to speak at your organization or place of worship, feel free to contact me.