

BANKRUPTCY GUIDANCE

- 1) HRC's Columns on Bankruptcy – specifically focused on her work to protect the collection of child support from coming second to paying back credit card debt.
- 2) Series of letters from the President to Congressional Leadership summarizing the Administration's concerns about the bankruptcy reform legislation. The May 12th letter is the most comprehensive, followed by two June letters outlining concerns with agreements coming out of the informal conference.
- 3) Currently, the White House is waiting for formal feedback from the Republican leadership on our major outstanding issues: fair-debt collection, homestead exemption, and the Schumer clinic violence amendment. As guidance is forth coming, we will forward it.

TALKING IT OVER

HILLARY RODHAM CLINTON

May 6, 1998

Over the past weeks, I've learned about proposed bankruptcy-reform legislation in the House of Representatives that could undermine the ability of some parents to collect child support. I have no quarrel with responsible bankruptcy reform, but I do quarrel with aspects of the bill that would force single parents to compete for their child support payments with big banks trying to collect credit card debt. The welfare of our children must come first.

Let me tell you about a hypothetical family: Jan and Simon have three children, ages 1, 3 and 5. Simon is the manager of a small shoe store with an annual salary of \$33,000. Jan is a full-time homemaker.

Sadly, they divorce, and Simon agrees to pay child support. Unfortunately, within a year, he's involved in a serious car accident and loses his job. Jan, struggling to raise their three children, stops receiving child support checks. Unable to find work, and behind on his bills, Simon files for bankruptcy protection. Jan is just one of his creditors.

Under current bankruptcy law, Simon is obligated to pay his taxes, his student loans and his child support and alimony. But under the legislation being considered by the House, certain of his credit card debts would also be mandatory. In Simon's case, as parties vie in the fierce competition for limited funds, child support payments and credit card obligations would be pitted against each other.

Unfortunately, Jan and Simon's story is all too common. This year alone, 1.4 million families will file for protection from unmanageable consumer debt under our bankruptcy laws. This represents an increase of about 400 percent since 1980. While some reform is in order, any accompanying threat to child support and alimony payments is not.

This administration has worked too long and too hard to improve child support collection to see it now threatened. The President has cracked down on non-paying parents and strengthened enforcement. Since 1992, collections are up 68 percent.

Today, families that file under Chapter 7 are relieved of certain debts, but as in Simon's case, they must still repay others, including taxes, educational loans and family and child support obligations. Many also try to continue making home mortgage and car payments. They leave court relieved of some debt but certainly not debt-free.

The aspects of the House bill that concern me would elevate certain types of credit card debt to the same high priority as taxes, school loans and family support. The challenge for Congress is to pass a law that is balanced and fair to both the creditor and the debtor -- protecting families and children while reducing abuse of the bankruptcy laws.

The challenge for our economy is to preserve access to credit while making sure that eligible consumers are educated, responsible and protected from

unscrupulous practices. It wasn't too long ago that large segments of our society were denied credit. At the time, it was important to provide people with this valuable economic tool, but now, as we all know, credit is readily available.

How many times in the past few months has your phone rung during dinner? You excuse yourself, leave the table and pick up the receiver, only to be greeted by a cheery voice on the other end of the line happily offering you a "pre-approved credit card." Or how many times have you seen or heard advertisements encouraging people with bad credit to borrow more?

For many people in financial straits -- for whatever reason -- such offers may sound too good to be true. Unfortunately, down the line, too many people find they didn't comprehend how much they would owe and don't have the means to repay the additional debt.

The average bankruptcy filer in this country earns less than \$18,000 a year after taxes. And, now, credit card companies even target college and high school students.

Most people use their credit cards responsibly and pay their bills reliably. But, for many Americans -- like Jan and Simon -- the difference between fiscal security and financial ruin is just one calamity away. A divorce, a lost job, an accident or a child's illness can rob a family of its financial security and eventually lead to bankruptcy court.

As members of Congress grapple with bankruptcy reform, they must deal with the problems that face both creditors and debtors. But one issue is clear. Any effort to reform the bankruptcy system must protect the obligations of parents to support their children.

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TALKING IT OVER

BY HILLARY RODHAM CLINTON

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The vast majority of the 1.4 million Americans who will find themselves in bankruptcy court this year are not criminals or shady characters. They are nurses and secretaries, carpenters and teachers, bank tellers and grocery-store clerks. On average, they make less than \$18,000 a year after taxes.

In other words, they are ordinary, hard-working Americans who want to pay their bills but who find themselves unable to manage, for reasons including the sudden illness of a child, a lost job and simply living too close to the financial edge.

Last May, I wrote about the flaws of bankruptcy reform legislation then under consideration by the House of Representatives -- legislation that could unfairly pit child support payments against credit card debt and fail to protect the poor, elderly and unwary from unscrupulous credit practices.

Unfortunately, despite some good faith efforts at improvement, the House proceeded to pass an unacceptable bill.

Bankruptcy reform is not easy. The challenge is to preserve access to credit, which is good for the economy, while curbing abuse and encouraging practices that help consumers live within their means.

The President supports reform that is both balanced and responsible. Debtors who have the genuine capacity to repay some of their debt should be required to do so, but abuses by creditors need to be stopped as well.

Thanks to the hard work of many legislators and advocates, the Senate has passed legislation, by a margin of 97 to 1, that goes a long way toward achieving the proper balance. Members of the Senate should be commended for taking the time and effort to reach a bipartisan resolution of some very tough issues. This week, when members of both houses sit down to reconcile the differences between the House and Senate versions, it is critical that this spirit of moderation prevail.

First, American consumers must not become the scapegoats of bankruptcy reform. Any reform must be even-handed, addressing the abuses of creditors as well as debtors.

One area demanding attention is called "reaffirmation," which occurs when a creditor, too often using threats or misinformation, convinces a debtor to agree to pay bills that could legally have been discharged in bankruptcy. One bankruptcy judge told me that when she reviewed her cases, she was astonished by the number of debtors who had agreed to reaffirm their unsecured debts even when it seemed to be against their best interests.

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We must ensure that, in the future, any reaffirmation of unsecured debt is actually in the debtor's best interest and not the result of coercive practices on the part of the creditor.

In addition, the law must require that creditors give consumers more and better information about their loans. Many consumers don't understand that when they pay only the minimum balance on their bills, it may take years to pay them off and may dramatically increase the cost of their purchases.

Think of it this way: If you charge a big-screen TV for \$2,500 on your credit card, figuring you will pay the typical monthly minimum charge at an average interest rate of 15.6 percent, it could take seven years to pay off the loan, and at the end of that time, you could have paid \$4,200, almost double the original cost of the television. For many, the costs are even greater.

Similarly, consumers may not understand that, when they are offered a "pre-approved" credit card, the company has not determined whether they can afford additional debt. This kind of information must be provided with the 3 billion unsolicited credit cards that are offered to Americans each year.

Another critical concern is how to decide who will obtain bankruptcy relief. The Senate, appropriately, would put these decisions in the hands of bankruptcy judges, who have an opportunity to look at each individual's situation. The House would remove most of the court's discretion under a misguided standard that fails to take into account the differing needs of families or local variations in living expenses.

It is important to note that no one leaves bankruptcy court entirely debt-free. Certain debts are "nondischargeable," meaning the court cannot forgive them. An additional problem with the House bill is that it would create new categories of nondischargeable debt that after bankruptcy could, in some cases, pit credit card debt against alimony, child support, taxes and student loans.

The bottom line is this: This Administration supports bankruptcy reform but only if it is fair and balanced. Americans who can repay a portion of their debts must do so. But at the same time, consumers must fully understand the costs of credit, and America's families must be protected from coercion and other predatory creditor practices. I hope the members of Congress will follow the Senate's lead and pass reform the President can sign into law.

To find out more about Hillary Rodham Clinton and read her past columns, visit the Creators Syndicate web page at www.creators.com.

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THE WHITE HOUSE
Office of the Press Secretary

For Immediate Release

June 29, 2000

TEXT OF A LETTER FROM THE PRESIDENT
TO THE SPEAKER AND DEMOCRATIC LEADER OF THE
HOUSE OF REPRESENTATIVES AND THE
MAJORITY AND DEMOCRATIC LEADERS OF THE SENATE

June 29, 2000

Dear Mr. Speaker: (Dear Mr. Leader:)

I write again because I am deeply concerned about recent developments concerning bankruptcy reform legislation pending before Congress. I understand the House and Senate Republican Leadership has reached a conclusion on a package they will soon move through the Congress. We have not seen the final language, but, if the reported description is accurate, I will veto the bill.

OMB Director Lew sent a letter to the informal conferees, on May 12, 2000, that laid out the principles against which I will judge any final bankruptcy bill that comes to my desk. I would like to sign a balanced consumer bankruptcy bill that would encourage responsibility and reduce abuses of the bankruptcy system on the part of debtors and creditors alike. The majority of debtors turn to the bankruptcy system, not to escape bills they can afford to repay, but because they face real hardship -- uninsured medical expenses, unemployment, or divorce. We can target the abuses without placing unnecessary barriers before those in need of a fresh start who turn to bankruptcy as a last resort. I remain concerned about the balance in the bill that the informal conferees have produced.

In addition, in my letter of June 9, 2000, I highlighted five issues that could help to determine whether the final bill meets my standards of balance and fairness. On three of these issues, the Republican resolution is seriously flawed.

First, I cannot support a bankruptcy bill that fails to require accountability and responsibility from those who use violence, van-dalism, intimidation, and harassment to deny others access to legal health services. Some have strategically abused the

bankruptcy system to avoid the penalties that Congress and the States have imposed for such illegal acts. The language that I understand the Republicans will include on this subject is inadequate. It would require a finding that there was a "willful and malicious threat of serious bodily injury" before certain debts would be made nondischargeable. Often, no such finding is made when holding parties liable for their actions in denying others access to legal health services under Federal or State law. The final legislation must include an effective approach to this problem, such as the one contained in the amendment by Senator Schumer, which passed the Senate by a vote of 80-17.

I am also concerned that the changes proposed to the Fair Debt Collection Practices Act would deny an effective remedy to victims of abusive check collection practices. We have yet to hear a compelling rationale for why check collectors should not be subject to the same requirements as those who collect other debts. Moreover, no committee in either body of Congress has considered this issue, raised for the first time in Conference. At a minimum, the proposal should be subject to full Congressional consideration, so that public scrutiny can be applied to the implications of the proposed changes.

The proposed limitation on State homestead exemptions will address, for the first time, those who move their residence shortly before bankruptcy to take advantage of large State exemptions to shield assets from their creditors. But the proposal does not address a more fundamental concern: unlimited homestead exemptions that allow wealthy debtors in some States to continue to live in lavish homes. In light of how other provisions designed to stem abuse will affect moderate-income debtors, it is unfair to leave this loophole for the wealthy in place.

I remain concerned that the negotiations have produced a bill that has lost some of the balance that the Senate bill had tried to achieve, albeit imperfectly from my perspective. As a result of all these concerns, I will veto the bill that we understand the Republicans plan to forward to my desk. But I continue to urge Congress to reconsider and send me a fair bill that meets the test of balance.

Sincerely,

WILLIAM J. CLINTON

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THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release

June 9, 2000

TEXT OF A LETTER FROM THE PRESIDENT
TO THE SPEAKER AND DEMOCRATIC LEADER OF THE
HOUSE OF REPRESENTATIVES AND THE
MAJORITY AND DEMOCRATIC LEADERS OF THE SENATE

June 9, 2000

Dear Mr. Speaker: (Dear Mr. Leader:)

I write to urge a fair resolution of the open issues in discussions on bankruptcy reform. I have long made clear my support for legislation that would encourage responsibility and reduce abuses of the bankruptcy system on the part of debtors and creditors alike. We also must ensure that a reasonable fresh start is available for those who turn to bankruptcy as a last resort when facing divorce, unemployment, illness, and uninsured medical expenses. Bankruptcy reform legislation should strike the right balance.

The House-passed bill was so one-sided that I would have vetoed it. The Senate-passed bill's bankruptcy provisions represented a better attempt to balance legitimate debtor and creditor interests, although I had serious concerns about some aspects. My Administration has watched carefully as the staff and informal conferees have sought to reconcile these two bills. While there appears to be some informal progress on some outstanding issues, it is very important that the resolution of these issues be fair and that we ensure that we do not erode protections for all debtors -- when targeting the few who abuse the system. The outcome will help determine whether the final bill tips the scales.

I am concerned, for example, that the final bill:

- may not adequately address the problem of wealthy debtors who use overly broad homestead exemptions to shield assets from their creditors;
- may weaken important credit card disclosure provisions that will help ensure consumers understand the implications of the debt they are incurring;

· may eliminate protections for reasonable retirement pensions that reflect years of contributions by workers and their employers; and

· may include an anti-consumer provision eliminating existing law protections against inappropriate collection practices when collecting from people who bounce a check.

Finally, I am deeply disturbed that some in Congress still object to a reasonable provision that would end demonstrated abuse of the bankruptcy system. We cannot tolerate abusive bankruptcy filings to avoid the legal consequences of violence, vandalism, and harassment used to deny access to legal health services. An effective approach, such as the one offered by Senator Schumer's amendment, should be included in the final legislation.

I sincerely hope that balanced, bipartisan bankruptcy reform will be completed this year, but I will not hesitate to veto unfair legislation that fails the test of balance.

Sincerely,

WILLIAM J. CLINTON

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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

May 12, 2000

The Honorable Patrick J. Leahy
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Senator Leahy:

The Administration understands that, although conferees have not been named, congressional staff are discussing ways to reconcile the House and Senate versions of H.R. 833, the Bankruptcy Reform Act. The enclosure to this letter outlines the Administration's views on these two versions of the bill. As you and your staff develop an agreement on this bill, your consideration of these views would be appreciated.

The President supports balanced consumer bankruptcy reform that would encourage responsibility and reduce abuses of the bankruptcy system on the part of debtors and creditors alike. He believes that we can eliminate abuse without hurting those forced to turn to bankruptcy, the vast majority of whom are faced with some of the hardest circumstances that life has to offer -- divorce, unemployment, illness, and uninsured medical expenses. Although we should not countenance people using bankruptcy to escape bills they can afford to repay, we also should not enact punitive legislation that places insurmountable barriers before the people who file for bankruptcy as a last resort. We must remember that too often those who need bankruptcy's "fresh start" are single mothers or divorcing spouses, displaced workers, low-income households (many of whom are minorities), victims of predatory lending, or those who faced unexpected illness that reduced their income and burdened them with expensive medical bills.

To meet the test of balance, the bill that emerges from conference should be consistent with the key principles that have been set forth by the President. The President was disappointed that the House once again failed to produce balanced bankruptcy legislation that he could support. As we stated when H.R. 833 came to the House floor last spring, the President's senior advisors would recommend that he veto the House bill if it were presented to him. The bankruptcy provisions of the Senate bill generally do a better job of meeting the President's principles, although the Administration has serious concerns about some provisions. The detailed enclosure describes the President's principles, the Senate bill provisions that should be preserved, the Senate bill provisions that raise concerns, and our strong objection to various provisions of the House bill.

The Administration notes that certain non-relevant amendments have been included in the Senate version of the bill. The President has made clear on a number of occasions that he strongly supports an increase in the minimum wage of \$1 over the next two years. However, as the Administration has stated previously, if Congress sends him a bill delaying the increase, repealing overtime protections for certain workers, adding costly and unnecessary tax cuts that threaten fiscal discipline and direct benefits away from working families, thwarting ongoing efforts to enforce pension law, and including an objectionable private school voucher provision, he will veto it.

Thank you for your consideration of the Administration's views on these bills. We would be happy to discuss any of these concerns with you or your staff.

Sincerely,



Jacob J. Lew
Director

Enclosure

Identical Letter Sent To The Honorable Orrin G. Hatch
The Honorable Henry J. Hyde, and The Honorable John Conyers, Jr.

**ADMINISTRATION VIEWS ON
H.R. 833 -- THE BANKRUPTCY REFORM ACT**

NON-RELEVANT AMENDMENTS

The Senate version of the bankruptcy bill includes non-relevant amendments on the subjects described below.

Minimum Wage and Tax Amendment

The President strongly supports an increase in the minimum wage of \$1 over two years. Working families across this country deserve this increase, which would restore the real value of the minimum wage to what it was in 1982, helping more Americans share in our current economic prosperity. But the Senate bill would delay the increase. The Senate bill also includes a provision that would repeal overtime protections for certain workers, and a tax and pension package that would direct benefits away from working families and reduce Federal unemployment taxes without addressing needed system reforms. These tax and pension provisions are regressive, could lead to cuts in retirement and health benefits for moderate- and lower-income workers, would not significantly increase plan coverage or national savings, and would hamper efforts to enforce pension law. Moreover, we must establish a proper framework for paying down the debt, strengthening Social Security and Medicare, and funding key priorities before we consider major new tax cuts. If the Congress sends the President a bill delaying the minimum wage increase, creating regressive, costly, and unnecessary tax cuts that threaten fiscal discipline, repealing protections for certain workers, hampering the enforcement of pension law, directing benefits away from working families and potentially reducing their retirement and health benefits, he will veto it.

Drug Amendment

The Administration also opposes the provisions that would reduce the current disparity between crack and powder cocaine sentences solely by increasing powder cocaine penalties dramatically instead of addressing both crack and powder cocaine penalties. Decreasing the threshold amount of powder cocaine that an individual must possess to receive 5- and 10-year mandatory minimum sentences may be counterproductive because it could significantly redirect Federal law enforcement resources from the most serious offenders. In addition, this amendment would actually exacerbate the disproportionate impact of cocaine sentencing on minorities because, according to U.S. Sentencing Commission statistics, approximately 31% of defendants sentenced at the Federal level for powder cocaine offenses in 1998 were African American, 48% were Hispanic, and only 19% were white. Please note, however, that the Administration supports many of the provisions contained in the amendment to combat the spread and abuse of methamphetamine and hopes that the Congress will consider them outside of bankruptcy legislation.

Private School Vouchers Amendment

The drug amendment discussed above also contains an objectionable school voucher provision that is unrelated to the underlying bill. The Administration's opposition to private school vouchers is well known. Rather than improving and reforming public schools, private school vouchers drain scarce resources from public schools and are a distraction from the serious work of education reform. Instead, the President is committed to a comprehensive agenda to improve our schools by investing more in them and demanding more from them. The Administration also opposes the provision to require States to mandate the expulsion of students who bring a "felonious" quantity of drugs onto school property. A similar provision was defeated in a bipartisan House vote during consideration of the juvenile justice bill last year, and we oppose the inclusion of this type of measure in bankruptcy legislation. Finally, the Administration objects to the inclusion of any provisions affecting elementary and secondary education in the bankruptcy bill, because the Elementary and Secondary Education Act of 1965 (ESEA) is currently being reauthorized in the House and Senate. Congress should continue to address elementary and secondary education issues through the ESEA reauthorization process.

CONSUMER BANKRUPTCY PROVISIONS

The President supports balanced consumer bankruptcy reform that would encourage responsibility and reduce abuses of the bankruptcy system on the part of debtors and creditors alike. To meet the test of balance, the bill that emerges from conference should be consistent with the key principles set forth by the President. The President was disappointed that the House once again failed to produce balanced bankruptcy legislation that he could support. As the Statement of Administration Policy said when H.R. 833 came to the House floor last spring, the President's senior advisors would recommend that he veto the House bill if it were presented to him. The bankruptcy provisions of the Senate bill generally do a better job of meeting the President's principles, although the Administration has serious concerns about some provisions.

Means Test

Principle: Access to Chapter 7 should not be governed by an arbitrary means test, but by reasonable guidelines that take into account individual circumstances. The goal of the means test is to identify those debtors who genuinely have the capacity to repay a portion of their debts under a Chapter 13 plan. Many debtors who now enter Chapter 13 fail to complete their plans. To ensure positive outcomes instead of higher failure rates and greater hardships, we should ensure that debtors' specific circumstances are considered in a meaningful way. Neither creditors nor debtors are helped by wasting scarce resources establishing and overseeing repayment plans that will quickly fail. The House bill fails to meet the President's principle (despite valuable efforts by Chairman Hyde to bring some balance to its provisions). Because it limits access to Chapter 7 through a tight, inflexible, and arbitrary means test, it would force into Chapter 13 repayment plans many debtors who are unlikely to succeed. Specifically, the House bill would:

- allow exceptions to the means test only to those demonstrating "extraordinary circumstances" that require additional exceptional expenses or income adjustments -- a nearly insurmountable burden of proof that would deny bankruptcy judges the appropriate discretion in the application of the means test.
- not allow for expenses related to the long-term care of family members, including the elderly and disabled. Such assistance may be essential to enable these family members to avoid institutionalization and maintain their quality of life, yet may not qualify the family member as a legal dependent of the debtor.
- not allow for expenses that debtors may incur in protecting themselves against domestic violence. These expenses could include relocation expenses to move away from the violent spouse, transportation expenses to get to work from a new location or to work removed from the spouse's knowledge, legal costs to get and enforce a protective order, security costs, and income gaps associated with unavoidable absences from work.
- rigidly use IRS guidelines that were designed for a different purpose -- collecting taxes -- where they are applied far more flexibly than the means test would allow. We urge the Conferees to adopt Chairman Hyde's proposal to authorize the creation of standards specific to bankruptcy, using the IRS guidelines as a starting point.
- not incorporate payments for arrearages on secured debt for necessary property, which must be paid under a Chapter 13 plan. Thus, the means test could leave some debtors in bankruptcy "no-man's land": unable to file under Chapter 7, but unable to get a Chapter 13 plan confirmed because they cannot pay these arrearages.
- subject many debtors to burdensome paperwork that is not needed for bankruptcy determinations, including the collection of back tax returns regardless of their relevance at a cost of millions per year.

The House bill does take into account required administrative expenses under a Chapter 13 plan in calculating whether the debtor has the capacity to repay. (This important provision, which is not in the Senate bill, should be retained in the final bill.) It also contains both essential safe harbors: (1) protecting below-median income debtors from 707(b) "abuse" motions by creditors that could be the basis for threats or coercion; and (2) protecting below-median income debtors from 707(b) means-test motions by bankruptcy trustees. It includes a proposal by Chairman Hyde to allow adjustments for reasonable food and clothing expenses to take into account regional differences in costs. Finally, it clarifies sensibly the definition of household goods that a debtor can claim as exempt property (and thus upon which the debtor can void a non-purchase money, non-possessory lien), by limiting household goods to those "normally" found in or around a residence. These provisions should be retained.

The Senate bill uses a more reasonable means test, which provides more-appropriate relief to debtors, although improvements could be made. The Senate bill would:

- allow exceptions to the means test to debtors who can show "special circumstances."
- use a more appropriate threshold for access to Chapter 7.
- provide a means test that includes expenses for the long-term care of elderly and other family members, and for protection of victims of domestic abuse and their families.

Certain provisions of the Senate bill, however, are also problematic.

- The Senate bill also uses IRS guidelines for the means test, but includes a Congressional finding that the Treasury Secretary can modify the guidelines for bankruptcy purposes. Because this interpretation of existing Treasury authority is subject to legal challenge, we prefer Chairman Hyde's approach described above.
- The Senate bill's means test calculation includes arrearages on secured debt for necessary property; however, it does leave some debtors in bankruptcy "no-mans' land" because it does not include the important provision, included in the House bill by Chairman Hyde, incorporating the required administrative expenses of a Chapter 13 plan in calculating the means test.
- The Senate bill avoids needless filing of back tax returns and streamlines the means test for debtors between 100% and 150% of median income. However, further reductions in the paperwork burden on low-income debtors could be achieved at no cost to the effectiveness of the means test.
- The Senate bill's motions safe harbor would protect below-median income debtors from 707(b) motions by creditors that could be the basis for threats or coercion. It fails, however, to provide a "safe harbor" for low-income debtors from means test calculations and paperwork or a full safe harbor from means test motions by United States trustees. Including both safe harbors would improve both the efficiency and fairness of the means test. If low-income debtors are abusing the process for other reasons, they would still be subject to general 707(b) motions by the court, the United States Trustee or the Chapter 7 trustee.
- The Senate bill's definition of household goods is so narrowly drawn that the debtor may be deprived of reasonable or even vital household items that would be exempt under the House bill's definition.

Finally, we note that both bills contain inconsistent references to median income standards (State, Regional, and National). Administration of the new law will be eased by use of consistent standards.

Homestead Exemption and Other Loopholes for the Wealthy

Principle: It is fundamentally unfair to ask low- and moderate-income debtors to devote future income to repay the debts that they can, while leaving loopholes that allow the wealthy to shield income and assets from their creditors. High or unlimited homestead exemptions allow people with expensive homes to avoid their responsibility to repay a significant portion of their debts. Similarly, some wealthy debtors can file under Chapter 11 where they can shield their future income from creditors.

The House bill provides a \$250,000 cap on homestead exemptions, but allows the states to opt out of the cap. With the opt-out, the provision is effectively the same as having no cap at all. Moreover, the bill does nothing to close the Chapter 11 loophole for wealthy debtors.

The Senate bill provides a meaningful cap of \$100,000 on homestead exemptions. It also closes the Chapter 11 loophole for wealthy debtors. These provisions should be retained.

Protection Against Coercive Reaffirmations and Practices

Principle: There must be appropriate safeguards against coercive creditor practices that compel debtors to forgo their rights and that disadvantage more scrupulous creditors. Debtors often reaffirm debt on unfavorable terms, sometimes when they demonstrably cannot afford the future payments. These new commitments put their future, as well as their payments to socially more important debts (e.g., child support, alimony, and taxes), at risk. These reaffirmations are frequently the result of insufficient or misleading information and sometimes the result of intimidation or outright coercion. Unfortunately, such practices have been all too frequent, and the new legislation may increase the risk of such coercion by giving creditors new opportunities to challenge debtors' actions. In light of these new opportunities for abuse, the Administration cannot countenance weakening existing protections; in fact, enhanced safeguards are essential.

The House bill gives debtors the right to a hearing on a reaffirmation of wholly unsecured, non-credit union debt, but allows represented debtors to waive the hearing, which effectively does little to change current law and might inadvertently bolster arguments that courts have no authority to review agreements filed by represented debtors. The bill expressly provides a private right of action for failure to comply with reaffirmation agreements or willful violations of a discharge, but it precludes use of class actions to bring such claims. This eliminates the most effective approach -- used in the Sears case among others -- to remedy widespread coercive practices. The private right of action should be retained, but the bar on class actions should be dropped.

The Senate bill does not ban class action remedies. Moreover, it requires disclosure of the terms of debt being reaffirmed and creates a new presumption of undue hardship if the debtor does not have the capacity to repay debts that he or she is reaffirming. These mechanisms will go a long way toward preventing debtors from reaffirming debts because of creditor threats or intimidation or because of simple confusion. The bill proposes a form of disclosure, although it is not as comprehensive as the one developed by the Administrative Office of the U.S. Courts now in use in a few districts; Congress could provide districts discretion to use the more extensive form. The new Subsection 524(j) in the Senate bill codifies existing practice by providing that creditors can accept payments before and after a reaffirmation agreement is filed with the court; however, if debtors exercise their right to rescind a reaffirmation agreement or the agreement is found to be invalid, subsections (j)(2) and (j)(3) may raise issues in litigation and should be clarified or struck. Specifically, Congress should clarify that nothing therein is intended to preempt any Federal or State law or eliminate remedies available under current Federal or State law, including disgorgement of funds collected under invalid agreements.

Finally, the Senate bill includes a provision that would allow debtors to waive in advance bankruptcy protection for their retirement assets. We fear that those of limited means or sophistication could easily be compelled, perhaps even as a condition of receiving credit, to put these critical assets at risk. As the Department of Labor recently testified before the Senate Health, Education, Labor and Pensions Committee, this provision should be struck.

Improving Credit Card Practices

Principle: Both debtors and creditors must be required to be responsible. Bankruptcy reform should be balanced by including provisions that address credit-card practices that may lead to bankruptcies. Creditors should give consumers the information they need to manage their credit card debt successfully. Doing so would allow more consumers to make informed decisions and give many households better control of their finances, reducing the number of bankruptcies.

The House bill requires that consumers receive a generic description of the impact of making only minimum payments on the duration of the debt. However, it provides no way for a consumer to obtain more specific information about the impact of making the minimum payment in his or her own circumstance. The House bill requires conspicuous disclosures of "teaser" rates, but it does not require that the rates be labeled "introductory" or that the permanent interest rate be disclosed in close proximity to the teaser rate.

The Senate bill provides more-useful provisions though it could be further improved. It requires most lenders to provide an 800 number for consumers who want specific information about the impact of minimum payments in their situation. (The information provided could be more valuable, if it included the cost as well as the duration of debt when only the minimum payment is made.) It also requires that consumers be given clear and conspicuous notice of teaser rates by labeling them as introductory each time they appear in a solicitation, as well as disclosure of the permanent interest rate in close proximity to the teaser rate. Lastly, the bill includes new disclosures on high loan-to-value home equity loans so consumers are not misled about their tax implications.

Non-Dischargeable Debts and "Cram Downs"

Principle: The goal of repaying creditors must be balanced with the need to protect social priorities, such as payment of child support, alimony and taxes, and to preserve a meaningful opportunity for a fresh start. The Bankruptcy Code makes debts nondischargeable only where there is an overriding public purpose to protect those debts. To the extent that the bills make more credit-card debt nondischargeable and preserve secured claims regardless of the value of their collateral, these societal priorities will compete for scarce resources and the fresh start will become ephemeral.

The House bill gives secured creditors in bankruptcy unprecedented rights to collect amounts in excess of the value of their collateral. It precludes "cramming down" debt to the collateral value for any debt secured by personal property purchased within five years of the bankruptcy filing. Were these provisions to become law, societal priorities would suffer, unsecured creditors would be placed at a disadvantage, and secured creditors would have less incentive to evaluate properly lending risk. The House bill also makes nondischargeable all cash advances above \$250 and all debts incurred to pay nondischargeable debts, both if within 90 days of bankruptcy. This rule endangers societal priorities and may trap debtors who are trying to feed their families or meet debt obligations before they realize that bankruptcy is inevitable.

The Senate bill is preferable because it protects under-secured debt other than for automobiles for only six months before filing; nonetheless, the ban for car loans should be far shorter than five years. Similarly, the Senate bill has a shorter window before bankruptcy in which cash advances (with a higher threshold) and debts incurred to pay nondischargeable debts become nondischargeable. An even better approach would be to limit the new nondischargeability provisions to above-median income debtors, as Senator Moynihan has proposed.

Barriers to Entry or Representation in the Bankruptcy System

Principle: Inappropriate barriers should not be created to entry into or effective representation in the bankruptcy system. Filing fees, fee-shifting provisions, and inflexible pre-filing hurdles can unfairly deny access to the bankruptcy system to people who do not have the ability to repay their debts.

The House bill would require mandatory credit counseling before a bankruptcy filing, but does not make clear that the requirement can be met by telephone or over the Internet, creating a barrier for those without convenient access to counseling. It also would require a debtor's attorney to pay a trustee's attorney's fees if the debtor is not "substantially justified" in filing for Chapter 7. Fear of such sanctions may deter attorneys from representing debtors with bona fide claims. However, the bill does allow courts to waive filing fees for debtors unable to pay, for the first time removing this important barrier to entry for indigent debtors.

The Senate bill ensures that mandatory credit counseling can be provided by telephone or over the Internet. It also applies an appropriate and more reasonable standard to the effort to deter abusive use of Chapter 7, allowing the trustee to recover reasonable costs from the debtor's attorney if filing under Chapter 7 was "frivolous." It also would allow courts to waive filing fees for indigent debtors, but would limit the courts' option to waive the fees only to debtors with incomes below 125% of the poverty level. We think no such cap is needed.

The Senate bill does require a debtor's counsel to attest under oath to the accuracy of any adjustments to income and expenses that the debtor provides (also under oath). This requirement will chill even the most responsible and scrupulous of attorneys from representing financially distressed debtors.

Prevent Abuse of Bankruptcy To Facilitate Clinic Violence

Principle: The abuses of the bankruptcy system must be stemmed, including abuse by those who would use bankruptcy to avoid penalties for violence against family planning clinics. The Administration is deeply concerned by the incidents of violence, vandalism, and harassment committed against family-planning clinics, some of which have resulted in the deaths and maiming of innocent people. The Administration believes that these unlawful activities must not be tolerated, and that when they are committed, those found liable should be held accountable. In 1994, Congress made clear its disapproval for those who would use unlawful means to deny citizens access to legal clinic services by enacting the Freedom of Access to Clinic Entrances Act (FACE).

Unfortunately, there is evidence that those found liable have been making strategic use of bankruptcy to avoid the penalties for their actions established by Congress and the States. This abuse of the bankruptcy system to facilitate unlawful behavior must not be tolerated. Senator Schumer's amendment, passed by the Senate by a margin of 80 to 17, would make court-ordered and other fines and debts resulting from family-planning clinic violence nondischargeable. The Administration opposes the expansion of categories of nondischargeable debt unless there is an overriding public policy objective and no other way to achieve that objective. The Schumer amendment meets that test, providing a necessary tool to ensure that bankruptcy is not used strategically to avoid the legal consequences of clinic violence and intimidation. It should be included in the final legislation.

Privacy Of Personal Financial Records In Bankruptcy

Principle: The financial and personal privacy of those who seek protection in the bankruptcy system must be protected.

The electronic aggregation and availability of public and non-public bankruptcy information could serve at least two important purposes: (1) it could lower costs for participants in the bankruptcy system; and (2) it could improve our understanding of bankruptcy trends and the impact of policy changes. The Administration strongly supports these goals. At the same time, however, disseminating bankruptcy information electronically could threaten the security and

privacy of debtors in bankruptcy by making sensitive information (including account numbers, social security numbers, balances, income sources, and payment histories) widely available to curious neighbors, employers, marketers, and predators looking for those most likely to be lured by scams.

Far too little attention has yet been given to complicated questions such as: who needs what information and under what circumstances? Does new technology change our perception of what information should be in the public domain? And what kinds of information in bankruptcy records could be used to prey upon debtors and their families?

These questions have been raised as private trustees explore the development of a national database of bankruptcy information to answer creditor inquiries about the status of payments under Chapter 13 plans. The database may contain material obtained independently by the private trustees in the administration of the case, as well as records from the public court file. Though such a database would provide creditors with one location to obtain information about their claims, important decisions must be made about privacy and the commercial use of this information. The private trustees appear interested in performing this function responsibly, and the Executive Office for U.S. Trustees is working with the private trustees to explore ways to safeguard the privacy of this information. However, legislative language in both the Senate and House bills designed to facilitate efforts by the private trustees without taking into account privacy considerations is, at best, premature.

The House bill would protect the private trustees from liability for dissemination of information unless a trustee has actual knowledge that the information is false. This provision provides no safeguards against misuse; and no compelling argument has been presented as to why the normal liability rules should not apply. We strongly recommend that this provision be removed from the final bill. In addition, the House bill also expresses the "sense of the Congress" that all public record data held by bankruptcy clerks shall be released in electronic form to the public, subject to privacy safeguards that the Judicial Conference may determine. The privacy issues regarding bankruptcy information should be fully explored before the Congress makes any determinations in this area.

The Senate bill contains language (in a section regarding collection of child support) that would require Chapter 13 trustees to provide non-public information about their cases to any not-for-profit entity that shall provide such information to parties in interest. The bill also contains "sense of the Congress" language about dissemination of bankruptcy information. The possible implications of these provisions, in particular the risk to personal privacy, have not been adequately explored, so these provisions should be dropped.

OTHER ISSUES

New Provisions

The Administration understands that consideration is being given to including, in the conference report, additional provisions that were not in either the House or Senate versions of the bankruptcy bill.

First, the Administration would strongly oppose the inclusion of provisions, under the bankruptcy law or other law, that would alter the police and regulatory exception or the legal principles that allow governmental units to enforce regulatory programs with regard to debtors who may hold interests in licenses, permits, franchises or entitlements issued by the Government.

Second, the Administration understands that some are urging adoption of an amendment that would exclude collection of bad checks from the provisions of the Fair Debt Collection Practices Act (FDCPA). The Administration would oppose such a provision. Courts have repeatedly found that check collection is covered by the FDCPA, which protects consumers from invasion of privacy, harassment, abuse, false or deceptive representations, and unfair collection methods. No compelling argument has been made explaining why these protections provided by the Congress are not as appropriate to collection of checks as they are to collection of other debts. In any event, before any such important consumer protections are weakened or eliminated, the case for the change should be subjected to sunlight and public scrutiny.

Certain Contract for Electric Power Voided

The Senate bill contains a provision that would void a power supply contract between Hydro Quebec and a consortium of Vermont utilities. While the intent of this provision appears to be to protect Vermont utilities that may be facing bankruptcy, the legislative abrogation of a contract between two commercial entities raises troubling policy issues, as more fully set out in a letter, dated March 3, 2000, to Senator Jeffords from Assistant Secretary for Fossil Energy Robert W. Gee. The Department of Justice has also raised concerns that the provision could give rise to a "taking" of private property for which just compensation would be required under the Fifth Amendment of the Constitution. It is also possible that a claim for money damages could be brought to international arbitration under NAFTA on the theory that NAFTA affords comparable protections to investments through the investment chapter's expropriation provision (Article 1110).

GUIDANCE ON BANKRUPTCY

May 22, 2000

Talking Points on General Bankruptcy Provisions

- We understand that the Republican House and Senate leaders with the Republicans late last week and “decided” amongst themselves – without any Democrats at the table -- a number of very important open issues.
- We have not seen language on these issues, so it is premature for us to express any views, but, based on what we are hearing **we – and a number of Democratic Senators – may have serious concerns about how the Republicans “decided” to resolve these essential issues.**
- As we noted in the Lew letter to Conferees, the President’s senior advisors would recommend that he veto the House bill if it were presented to him. The Senate bill generally was closer to meeting the President’s principles, but we continued to have serious concerns even about that.
- The President ultimately will evaluate the final bill and whether he gives it his signature depends on whether it meets a test of balance -- fairness to creditors and debtors alike. As the members continue to compromise between the House and Senate provisions, the balance continues to slip.

If asked: Are you saying the President is going to veto the bill?

- That remains a “viable option.” We’ll have to see where the balance lies in the end.

Background

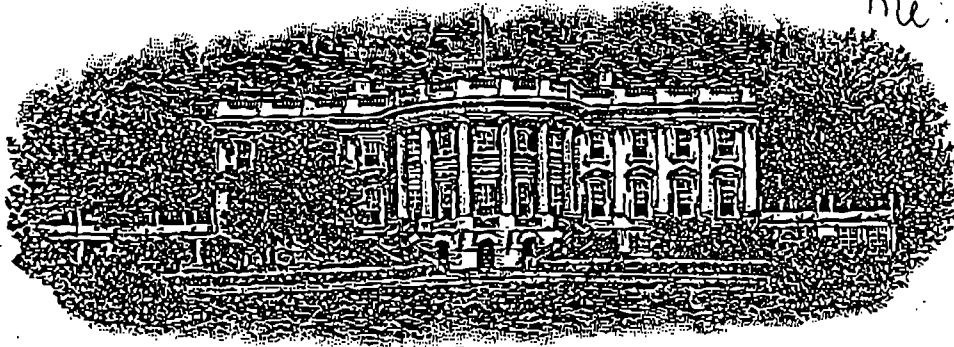
- The open issues that reportedly the Republicans “decided” are:
 - **Homestead Exemption:** No cap on state homestead exemptions (except for within 3 years of purchase). We may question if it is fair to allow wealthy debtors to shield assets from creditors in unlimited homesteads while forcing moderate income debtors to pay more and more to their creditors.
 - **Bounced Check Collection Exemption from the Fair Debt Collection Practices Act:** Deny people whose rights under the Fair Debt Collection Practices Act are abused by those collecting bounced checks (e.g., threatening phone calls, harassment, notifying an employer of debts) effective protection of the FDCPA by precluding award of attorneys fees in judgements for bounced checks. The FTC has said there is no policy

basis for distinguishing between bounced checks and collection of other debts. Moreover, this provision was in neither House nor Senate bill. We may argue that the addition of an anti-consumer provision in the “dark of night” without sunlight or scrutiny is inappropriate.

- **“Small Bank” Exemption for Credit Card Disclosures:** Senator Torrecelli fought for new disclosures for consumers of the impact of making minimum payments on credit cards. In addition to an example, consumers can call a toll free number to find out more about how long it will take them to repay their individual debt if only making minimum payments. Senator Gramm apparently sought an exemption for “small banks” -- over 80% of institutions, leaving their customers without access to this essential information. The Administration strongly opposed “small bank” carve outs from CRA and this may raise similar concerns.
- **Means Test Safe Harbor:** Republicans apparently decided against including an exemption Rep. Hyde won in the House that would mean that trustees and judges are not required to subject below-median-income debtors to scrutiny under the means test. The absence of Representative Hyde’s safe harbor means that the trustees and court must go through needless paperwork and procedures which will yield no additional repayment and impose unnecessary burdens on low income debtors with no where else to turn.
- **Clinic Violence:** The Republican final offer (as described) would make nondischargeable those debts that result from all intentional acts of violence (i.e., the amendment is not limited to violations of the FACE Act). Senator Schumer, the sponsor of the amendment, and abortion rights advocates strongly oppose this formulation because most clinic violence awards would not qualify. As a result, the bill would continue to allow those who commit violence outside family planning clinics to use the bankruptcy courts to shield them from liability for their violent acts.
- **Pension Protection Cap:** Apparently, the Republicans have agreed to put a cap on the amount of pension benefits a person can protect in an IRA during bankruptcy. While the administration agrees that a debtor should not be able to shield abundant resources from creditors, we are still scrutinizing to consider whether this provision strikes the right balance. Concerns are raised about whether the cap is consistent with efforts to encourage greater voluntary retirement savings, would impact those whose pensions provide for only a modest standard of living, and whether it treats different kinds of pensions fairly.

Reaffirmation
Study from
Sarah Rosen

Re Bankruptcy
reform act re:
child support



He: bunnings

THE WHITE HOUSE

National Economic Council

Phone: (202)-456-5351

Fax: (202)-456-2223

TO: Ann O'Leary

PHONE: _____

FAX: 6-2878DATE: 4/28/00PAGES TO FOLLOW: 5

COMMENTS: _____

If this fax is incomplete or you need to provide clearance information for a meeting, please call
~~Rachael Goldfarb at 456-5351 or email Rachael_F_Goldfarb@epd.eop.gov.~~ Thank you.

Sarah Rosen-Wartell @ 456-2801.

**CREIGHTON
UNIVERSITY**

School of Law

April 17, 2000

Ms. Sarah Rosen
Senior Adviser: Financial and
Regulatory Issues
National Economic Council
233 Old Executive Office Building
Washington, DC 20500

Dear Ms. Rosen:

We have recently published the results of an extensive study of reaffirmation. We found:

1. Many debtors reaffirm: 28% of our Chapter 7 debtors reaffirmed one or more debts.
2. The dollars are significant: the average amount reaffirmed was \$10,300 per case.
3. Counsel too often approved reaffirmations the debtors could not afford: 52% of the debtors had no income or negative cash flow after reaffirmation payments.

An executive summary is enclosed. The full article, "Debt After Discharge: An Empirical Study of Reaffirmation," can be found in 73 American Bankruptcy Law Journal 709 (Fall, 1999).

We have reviewed the Senate amendments to the reaffirmation provisions of HR 833. Our research shows these provisions are seriously flawed.

PROBLEM #1: The bill fails to require that the creditor file a reaffirmation agreement with the court, and it fails to provide a civil sanction to enforce that requirement. Prompt filing is crucial to allow counsel and/or the court to protect the debtor's fresh start from unduly burdensome agreements. The filing requirement has been evaded on a massive scale under current law. Sears and other major consumer creditors enforced tens of thousands of reaffirmation agreements they had deliberately failed to file. Most of these agreements would never have been approved had they been filed as required. The bill as written would not stop this abuse.

April 17, 2000

Page 2

SOLUTIONS:

1. Require the creditor to file the reaffirmation agreement.
2. Provide sanctions, including actual damages and reasonable attorney fees, and in appropriate cases, punitive damages, for violations of the reaffirmation and discharge provisions.

PROBLEM #2: Like the current Code, the bill makes debtor's counsel, rather than the court, the primary gatekeeper of reaffirmation. Our research shows that debtor's counsel too often approve reaffirmations debtors cannot afford. Fully 52% of our sample debtors had either \$0 or a deficit after reaffirmation payments and other expenses were subtracted from monthly income. Yet debtor's counsel certified, in the vast majority of these cases, that the reaffirmation would not unduly burden the debtors.

SOLUTION: Require the court, rather than counsel, to certify that a reaffirmation will not unduly burden the fresh start.

PROBLEM #3: The bill allows enforcement of reaffirmations without court oversight even if payments would entirely exhaust the debtor's monthly income. The bill raises a presumption of undue hardship only if reaffirmation payments and other expenses exceed monthly income and so produce a monthly deficit. This leaves no margin for the inevitable unexpected expenses, and virtually ensures continuing financial distress. Yet the same bill's own means-testing provisions allow a monthly cushion of \$250 before presuming abuse. Allowing a realistic cushion for the unexpected is all the more important since this bill also makes debtors wait years longer to get a second discharge.

SOLUTION: The presumption of undue hardship, if retained at all, should arise whenever the schedules show that reaffirmation payments plus other expenses leave the debtor with less than \$150 to \$250 per month. Further, all agreements falling within the presumption would require court review.

PROBLEM #4: No one can adequately evaluate an agreement if its terms are not disclosed. First, the bill requires use of a form reaffirmation agreement which incorporates the terms of the original prebankruptcy contract between the debtor and creditor. However, the bill does not require the creditor to produce a copy of that original agreement signed by the debtor. Second, the bill allows use of variable interest rates. The creditor could double the interest rate the day after discharge, and the debtor's previously affordable payments would become an impossible burden. Yet under the bill, the debtor would be bound.

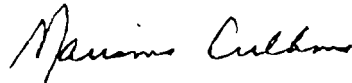
April 17, 2000
Page 3

SOLUTIONS:

1. Require the creditor to attach a copy of the original contract signed by the debtor to the reaffirmation agreement.
2. Require the reaffirmation agreement to carry a fixed interest rate.

We would be happy to discuss these matters. We can be reached by phone or e-mail at the numbers below.

Very truly yours,



Marianne Culhane
Professor of Law
culhane@culaw.creighton.edu
(402) 280-3154



Michaela M. White
Professor of Law
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MMW/pa
Enclosure

DEBT AFTER DISCHARGE: AN EMPIRICAL STUDY OF REAFFIRMATION

by Marianne B. Culhane and Michaela M. White
Professors of Law, Creighton University School of Law

EXECUTIVE SUMMARY

Reaffirmation preserves personal liability that would otherwise be discharged in bankruptcy. To protect the debtor's fresh start, Bankruptcy Code section 524(c) requires reaffirmation agreements to:

1. be made before discharge,
2. be filed with the bankruptcy court,
3. disclose the debtor's right to rescind, and
4. be certified by debtor's counsel or the bankruptcy judge as not unduly burdensome to the debtor.

No government agency tracks reaffirmation, and there are few recent studies of the practice. We hope to fill that void. With funding from the National Conference of Bankruptcy Judges, we examined a sample of 1043 Chapter 7 cases filed by individual and joint debtors in 1995, from seven districts across the nation. In "Debt After Discharge," we report what we found in the files.

Our report understates the total number of reaffirmation agreements signed by debtors. Because our data is drawn from court files, we capture only reaffirmations that were filed with the court. However, major creditors such as Sears, GE Capital and Discover Card recently confessed to collecting tens of thousands of reaffirmations which they deliberately failed to file. These "rogue reffs" are not legally enforceable, but misled many debtors into believing they were bound. These rogues remain under our radar.

Nevertheless, the 446 reaffirmations filed in our sample cases suffice to paint a disturbing picture. Among our findings:

1. Many debtors reaffirm. Overall, 28% of the sample cases had one or more reaffirmations in the file.
2. Debtors reaffirm substantial dollar amounts. Those 28% reaffirmed a mean amount per case of \$10,300.
3. Debtor's counsel too often approved reaffirmations that schedules show the debtors could ill afford. Fully 52% of the reaffirming debtors in our sample had no income (many had a steep deficit) after reaffirmation payments and other monthly expenses.

4. Reaffirmations were not filed in the majority of cases where debtors wished to keep cars and homes used as collateral. This pattern prevailed even in districts which deny debtors a right to retain collateral without reaffirmation.
5. Almost half the reaffirmations filed were of household goods debt, even though such collateral loses value quickly and is less likely to be repossessed. Just under 10% of the reaffirmations were of wholly unsecured debt. Aggressive creditor solicitation, with offers of new credit at very high (but undisclosed) effective interest rates, may explain these reaffirmations of household goods and unsecured debt.

These findings show that reaffirmation places too great a burden on the fresh start, and that debtor's counsel have been ineffective gatekeepers. Therefore, we recommend that Congress:

1. Require the court, rather than counsel, to certify that a reaffirmation will not unduly burden the debtor's fresh start.
2. Extend Truth-in-Lending's disclosure requirements to reaffirmations, so that debtors, counsel and courts can accurately assess the costs involved.

Those are the principal findings of Phase I of the Reaffirmation Project. We are now at work on Phase II, along with Professor Gary Neustadter of Santa Clara Law School. Phase II involves interviews with debtors, creditors, trustees and judges to pursue questions not answered in the bankruptcy court files.

file: bankruptcy

John O'Leary

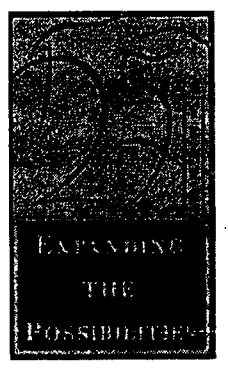


NATIONAL WOMEN'S LAW CENTER

March 15, 2000

The Honorable William J. Clinton
President of the United States
The White House
Washington, DC 20500

Re: **H.R. 833, Bankruptcy Reform Act**



Dear Mr. President:

As you know, our organizations have taken the lead in speaking on behalf of the many organizations representing women and families that have been actively involved in the debate over bankruptcy reform. We write today because we are at a critical juncture in that process, and it is important that the Administration set the tone and parameters for the final debate if we are to emerge with a bill that is fair and balanced.

It is our hope that the Administration will stand with women and children and insist that the final package of reforms include the Senate means test, as modified by the Hyde amendment and with additional improvements offered by Senate Democrats on the floor. In addition, we are hopeful that several amendments offered in the Senate and labeled the "families package" will be included in the final bill, along with the House provision on household goods. In particular, we would like to see the Dodd/Kennedy/Landrieu amendment adopted so that women owed child support are not forced to compete with powerful credit card companies for the scarce financial resources of a bankrupt former spouse.

We appreciate the efforts of your Administration to improve the bankruptcy bill, and were heartened by the strong votes received by many of the amendments offered by Democrats in the Senate. We respectfully encourage you to continue to stand up for fairness and balance in the bill and to stand firm in your opposition to a bill that does not accomplish this worthy goal.

Sincerely,

Joan Entmacher

Joan Entmacher,
Vice President and Director of Family Economic Security
National Women's Law Center

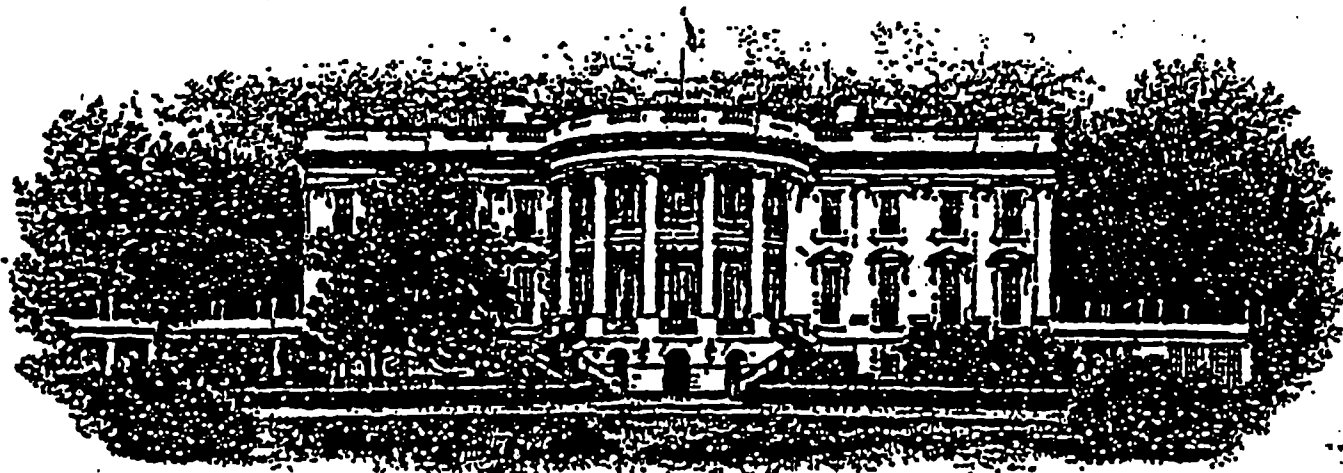
Judith L. Lichtman

Judith L. Lichtman,
President
National Partnership for Women & Families

cc: John Podesta, Office of the President
Charles Burson, Office of the Vice President
Melanne Verveer, Office of the First Lady

File: Blanketing

THE WHITE HOUSE
WASHINGTON, DC 20500



FAX COVER SHEET

DATE: June 5, 2000

TIME: _____

TO: Melanne Verveer,
Chief of Staff to the First Lady

PHONE: _____

FAX #: 202-455-4053
4303

FROM: Ann O'Leary

PHONE: (202) 456-_____

PAGES AFTER COVER: 5

COMMENTS: _____

GUIDANCE ON BANKRUPTCY

May 17, 2000

Talking Points on General Bankruptcy Provisions

- We understand that the discussions are still continuing and that some especially contentious and important issues remain open – including whether they will:
 - ensure fairness by capping the homestead exemption that wealthy debtors use to shield assets from creditors;
 - provide a safe harbor for low income families;
 - allow creditors to trick the unsuspecting into waiving bankruptcy protection for their pensions;
 - allow those who commit violence outside family planning clinics to use the bankruptcy courts to shield them from liability for their violent acts; and
 - include a last minute, “dark of night,” anti-consumer provision allowing creditors to harass and defraud people who bounce checks.
- We are monitoring closely, but it is premature to have a final assessment of the bill.
- As we noted in the Lew letter to Conferees last week, the President’s senior advisors would recommend that he veto the House bill if it were presented to him. The Senate bill generally was closer to meeting the President’s principles, but we continued to have serious concerns even about that.
- The President ultimately will evaluate the final bill and whether he gives it his signature depends on whether it meets a test of balance -- fairness to creditors and debtors alike. As the members continue to compromise between the House and Senate provisions, the balance continues to slip.

If asked: Are you saying the President is going to veto the bill?

- That remains a real possibility. We’ll have to see where the balance lies in the end.

Talking Points on the Fair Debt Collection Practices Act

- The Fair Debt Collection Practices Act (“the FDCPA”) provides essential protections for consumers from abusive practices by check collectors including: invasions of privacy, harassment, false or deceptive representations, and unconscionable collection methods. For example, it precludes late night and repetitive phone calls, leaving a message with your employer that you are a deadbeat [delinquent on your debts], and false threats of legal action.
- There was nothing about the FDCPA in either the House or Senate bill and yet, Senator Hatch now seems determined to add a special interest provision that would exclude the collection of bounced checks from some or all of the protections of the FDCPA.

- This appears to be a grossly anti-consumer provision and has no place in this legislation – most especially added at the last minute without sunshine and public scrutiny.
- The FTC argued in a 10th Circuit brief (in a case where the court upheld their view) that:
 - The purpose of the FDCPA “applies no less forcefully to third-party check collection than to third-party collection of other types of consumer debt”
 - The same abusive practices exist in check collection as in collecting on revolving debt [paraphrase]; and
 - “The policy and purpose of the Act warrant treating the collection of dishonored checks no differently from the collection of other consumer obligations.”
- **[If they argue that it simply effects capacity to collect legal fees:** “Private remedies are an essential aspect of the enforcement scheme under the FDCPA. But if a debtor, in financial difficulty, is unable to recover the cost of legal representation from those who are grossly abusing their rights, they will never be able to vindicate those rights.”]

Background

From the Administration’s views letter, dated May 12, 2000: “The Administration understands that some are urging adoption of an amendment that would exclude collection of bad checks from the provisions of the Fair Debt Collection Practices Act (FDCPA). Courts have repeatedly found that check collection is covered by the FDCPA, which protects consumers from invasion of privacy, harassment, abuse, false or deceptive representations, and unfair collection methods. No compelling argument has been made explaining why these protections provided by the Congress are not as appropriate to collection of checks as they are to collection of other debts. In any event, before any such important consumer protections are weakened or eliminated, the case for the change should be subjected to sunlight and public scrutiny.”

Requirements of the FDCPA:

- The standards protect a consumer from invasion of privacy, harassment, abuse, false or deceptive representations, and unfair or unconscionable collection methods.
- Specific acts that are prohibited include late night or repetitive phone calls and false threats of legal action.
- The Act gives a consumer the right to require a collector to stop all collection contacts.
- It requires a collector to deal with a consumer's attorney when the consumer has one.
- It gives a consumer the right to require a collector to verify the existence, legality, or amount of a disputed debt it is attempting to collect.
- The courts require strict adherence to the Act's explicit terms to accomplish the

remedial and preventative goals of Congress.

From the FTC's brief filed in the 10th Circuit in Snow v. Riddle in May 1997:

"The public policy relevant to construing the FDCPA is that stated expressly by Congress in the statutory preamble, e.g.:

- that "[t]here is abundant evidence of the use of abusive, deceptive, and unfair debt collection practices by many debt collectors," 15 U.S.C. § 1692(a); that such practices "contribute to the number of personal bankruptcies, to marital instability, to the loss of jobs, and to invasions of individual privacy,";
- that "[m]eans other than misrepresentation or other abusive debt collection practices are available for the effective collection of debts," and
- that "those debt collectors who refrain from using abusive debt collection practices [should not be] competitively disadvantaged."

"Each of these stated statutory purposes applies no less forcefully to third-party check collection than to third-party collection of other types of consumer debt. The abusive practices that the FDCPA prohibits may be applied as readily to collection of dishonored checks as to other types of debt collection, and the consequences for the debtor from the exercise of disproportionate remedies may be just as great. Likewise, there are lawful means to collect dishonored checks, and there is no evident reason why those who refrain from the abusive tactics addressed by the FDCPA in collecting dishonored checks should be competitively disadvantaged."

"Case law since passage of the FDCPA confirms that debts arising from dishonored checks, and the collection activities resulting therefrom, implicate the same range of concerns as debts that arise from default on installment obligations. For example, collection actions against some consumers may stem from different consumers' use or misuse of a joint account Sometimes insufficient fund checks are written because the consumer misinterprets the bank's policy regarding crediting deposits or honoring overdrafts. . . . In other cases involving dishonored checks, consumers may have valid defenses that the FDCPA is designed to let them assert (e.g., plaintiff dunned for presentation of an insufficient check alleged that she had paid her account in cash). Some targets of dishonored check collection are themselves the victims of check fraud, such as the Vermont consumer . . . who were dunned for checks that had been stolen from them and forged. In still other cases, checks are dishonored because consumers deliberately stop payment on them in the face of seller nonperformance. And some consumers are unlucky, careless, or irresponsible in the management of their personal finances and find themselves subjected to claims out of all proportion to the underlying debt and to misleading threats of suit."

"The Commission holds no brief for individuals who deliberately pass worthless checks. But the remedy for such abuses, when they occur, lies in public enforcement of applicable criminal laws and private enforcement of parallel civil remedies, not in a

special license for debt collectors to harass alike the guilty, the careless, the unfortunate, and those who do not owe a debt at all. Congress has chosen to establish in the FDCPA uniform national standards of conduct for third-party debt collectors. ***The policy and purpose of the Act warrant treating the collection of dishonored checks no differently from the collection of other consumer obligations. “***

file: bankruptcy

THE WHITE HOUSE

WASHINGTON

May 10, 2000

MEMORANDUM FOR HILLARY RODHAM CLINTON

FROM: ANN O'LEARY

CC: MELANNE VERVEER
SHIRLEY SAGAWA
LISSA MUSCATINE

SUBJECT: BANKRUPTCY BILL

I wanted to be sure that you saw this *Time* magazine article regarding the bankruptcy bill. It makes a powerful case that this bill would place an undue burden on low and middle-income bankruptcy filers who have been impacted by difficult life circumstances from job loss to serious illness to divorce. It argues that the bankruptcy reform agenda has been overtaken by campaign contributions from the credit card and banking industry which has prohibited most of the pro-consumer reforms advocated by the Administration and the consumer groups.

Today, Maria Echaveste with Gene Sperling conducted a conference call with a coalition of civil rights advocates who were making the point that this article is helping to slow-down movement on the bankruptcy reform bill. The group included Wade Henderson, Professor Elizabeth Warren from Harvard, and Senator Howard Metzenbaum among others. They made the point that we are at a critical juncture in the bankruptcy reform debate. The shadow conferees (an informal self-appointed Senate and House conference committee) are expected to come out with their proposal early next week and the Administration has yet to send a position letter to the Hill. The group recommended that we up the ante on our rhetoric and highlight the impact this bill will have on women, families, and low to middle-income homeowners. They also suggested that the President use the bully pulpit to closely link this bill to the need for campaign finance reform (as suggested in the *Time* article).

Gene Sperling made the point that our letter will be strong on our continued call for a veto on a final bill that is close to the House version of the bill. It will outline our substantive concerns from the homestead exemption to arbitrary means testing. In the end, however, we will recommend that the President sign a final bill that is close to the Senate version of the bill and we will not put him in a position of vetoing a bill with a certain veto override. Gene did offer, however, to increase the rhetoric and we will work with him to do so before the letter is sent to the Hill. Attached please find the latest version of the letter (without the turned-up rhetoric).

Please let me know if you agree with this strategy or if you would like to weigh in on any suggested changes to the attached letter before it goes to the Hill.

Thank you.

May 5, 2000

MEMORANDUM FOR THE PRESIDENT

CC: JOHN PODESTA

FROM: GENE B. SPERLING
SARAH ROSEN WARTELL

RE: BANKRUPTCY LEGISLATION

ISSUE PRESENTED:

The NEC Bankruptcy Working Group has prepared a letter to the Congress setting forth our detailed views on the House and Senate bankruptcy reform bills. Both of these bills passed by overwhelming margins, despite our threat to veto the House bill and the important reservations we expressed about the Senate bill. Consumer groups continue to oppose these bills. Many major editorial pages have been critical of both bills, although most are more favorable toward the Senate bill. We expect some will oppose the final product. The letter to Congress would reiterate our previous statements: It again threatens to veto the House bill and says that the Senate bill better meets your principles, although we have some serious concerns. Despite the lengthy criticism of the bills' provisions, the letter effectively signals that you are likely to sign the final legislation unless it contains the most noxious House provisions or drops most of the consumer and debtor protections achieved by Senate Democrats. We seek your reaction to this strategy before the letter is sent.

VIEWS OF YOUR ADVISORS:

All of your advisors support balanced bankruptcy reform. All believe that the final bill will do some good by encouraging personal responsibility and lowering credit card interest rates that are inflated because some debtors are too ready to use and even abuse Chapter 7's bankruptcy discharge. All of your advisors also agree that, due to an expensive lobbying effort by the credit card industry, the final bill will lack the balance we sought and will not demand similar responsibility from the credit card industry.

An important issue is whether or not the new rules, determining who should be required to go into Chapter 13 (which requires repayment of what a formula says you can repay), are flexible enough to deal with specific cases of hardship in unusual circumstances. The provisions we have pushed for – ultimately allowing the bankruptcy trustees and courts greater discretion – have been largely rejected. We have made reasonable progress in the bill in other areas; for example, the bill protects child support and alimony from competition from credit card debt in many cases and includes a safe harbor from the means test for below-median-income debtors.

Assuming that the final bill that comes to your desk is close to the Senate bill, all of your advisors agree that you should sign it, although for somewhat different reasons. Jack Lew, Chuck Brain, and Gene Sperling believe that, while the final bill may be on the whole a net minus, it is a relatively close call, and not worth the political downside of a veto override. Larry Summers believes that a final bill relatively close to the Senate bill is a net plus and should be signed on the merits. Bankruptcy reform, Larry argues, will have an impact similar to that of open trade: a few visible cases of hardship, but a larger less visible benefit of lower interest rates for credit card borrowers.

All of us feel that, while it is unfortunate that we do not have a more balanced bill, if the final bill stays relatively close to the Senate bill, it would be better to sign the bill with some reservations than to risk a veto override. For you to have any chance of sustaining a veto, or even to make a strong public statement through an override, we would need to launch a high profile battle against a "paid-for" bankruptcy bill – a battle that would indirectly put us at odds with friends like Senators Daschle and Torricelli, and allow others to say we were walking away from our individual responsibility message.

BACKGROUND:

Last May, the House bill passed by a veto-proof margin of 313 to 108. A Democratic substitute that we crafted with Congressman Nadler received only 149 votes and had no effect on our effort to give enough Democrats cover to help us achieve a veto-sustaining margin. Key House Democratic leaders, including Representatives Martin Frost, Bob Menendez, and Patrick Kennedy supported the underlying bill and opposed the Nadler substitute. Minority Leader Gephardt opposed the bill, although he announced his position well after other Members' positions in support had settled. When we talked to Senate Democrats, we found few were interested in our substantive concerns and many were eager to see a reform bill enacted. Some were willing to press for changes and modest improvements were achieved as a result. But few Senate Democrats were willing to oppose the legislation despite its imbalances. As a result, an improved but flawed bill passed the Senate by a vote of 83-14. Democrats opposing the bill on bankruptcy grounds were Senators Kennedy, Wellstone, Dodd, Feingold, Harkin, Reed, Sarbanes, Schumer, Lautenberg, and Moynihan. (A few of the 14 opposed the bill for other reasons.)

Although a formal conference committee has not been named, Congress is now working to reconcile the House and Senate bills. Republican and Democratic leadership expect to attach the bankruptcy provisions to a conference report on other legislation (perhaps Digital Signatures or Crop Insurance) in order to avoid procedural roadblocks placed by Senators Wellstone and Kennedy in trying to force another Senate vote on a two-year minimum wage increase.

The NEC working group drafted a letter to the informal conferees setting forth the Administration's detailed views on various provisions of both bills. It reiterates your senior advisors' veto threat that we issued on the House version of the legislation last May. It describes the Senate bill as more balanced and doing a better job of meeting your principles, although it details serious concerns we have about some of the Senate bill's provisions.

In a few cases, the letter explains that the House language is actually better than the Senate approach. (The letter also reiterates the veto threat on a bill including the minimum wage, tax, and school voucher amendments that were attached to the bill by the Senate, but we expect those non-relevant provisions to be dropped.) (Copy of cover letter at Appendix A.)

Your senior advisors believe that the relatively muted tone of this letter signals that you are likely to sign the final legislation, albeit with reservations. The details in the letter provide helpful guidance to the Democratic negotiators attempting to improve the bill in conference. Unless we significantly raise the level of our rhetoric now, your advisors will likely recommend that you sign the final bill, unless it drops the most visible improvement achieved by Senate Democrats or includes the most noxious aspects of the House bill.

Appendix B is a more detailed summary of some of our substantive concerns with the House and Senate Bills.

DECISION:

Proceed with Letter _____

Let's Discuss _____

[Date]

The Honorable Orrin G. Hatch
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Chairman Hatch:

The Administration understands that, although conferees have not yet been named, your staff are discussing ways to reconcile the House and Senate versions of H.R. 833, the Bankruptcy Reform Act. The attachment to this letter outlines the Administration's views on these two versions of the bill. As you and your staff develop an agreement on this bill, your consideration of these views would be appreciated.

The President supports balanced consumer bankruptcy reform that would encourage responsibility and reduce abuses of the bankruptcy system on the part of debtors and creditors alike. To meet the test of balance, the bill that emerges from conference should be consistent with the key principles set forth by the President, as described in the enclosure. The President was disappointed that the House once again failed to produce balanced bankruptcy legislation that he could support. As we stated when H.R. 833 came to the House floor last spring, the President's senior advisors would recommend that he veto the House bill if it were presented to him. The bankruptcy provisions of the Senate bill generally do a better job of meeting the President's principles, although the Administration has serious concerns about some provisions.

The Administration notes that certain non-relevant amendments have been included in the Senate version of the bill. The President has made clear on a number of occasions that he strongly supports an increase in the minimum wage of \$1 over the next two years. However, as the Administration has stated previously, if Congress sends him a bill delaying the increase, repealing overtime protections for certain workers, adding costly and unnecessary tax cuts that threaten fiscal discipline and direct benefits away from working families, thwarting ongoing efforts to enforce pension law, and including an objectionable private school voucher provision, he will veto it.

Thank you for your consideration of the Administration's views on these bills. We would be happy to discuss any of these concerns with you or your staff.

Sincerely,

Jacob J. Lew

Enclosure

Identical letters sent to The Honorable Patrick J. Leahy,
The Honorable Henry J. Hyde, and The Honorable John Conyers, Jr.

SUBSTANTIVE CONCERNS WITH THE HOUSE AND SENATE BILLS

Homestead Exemption: The Senate bill includes a \$100,000 cap on the amount of home equity that states can allow debtors to shield from their creditors. The House bill has a cap of \$250,000, but allows a state to opt-out, effectively eviscerating the cap. We have argued that it is fundamentally unfair to ask moderate-income debtors to repay what they can, while wealthy debtors can shield their resources in expensive homes. Most expect that the Senate cap will be dropped in conference, although rhetoric on this issue has the greatest potential to embarrass bill proponents.

Credit Card Protections: Although the provisions in both bills are weak, the Senate is somewhat stronger, providing new disclosures on teaser rates and the impact of making only the minimum payment on the length of time one will be repaying debt. Senate Democrats, including the leading Democratic bill proponent Senator Torrecelli, say they will oppose a conference report that further weakens these provisions, so the Senate provisions are likely to survive intact.

Means Test for Chapter 7 Discharge: Both bills use IRS tax collection guidelines to establish tests to determine whether a debtor has the capacity to repay a portion of their debt under a Chapter 13 repayment plan. If so, filing for a Chapter 7 discharge is deemed abuse. The House test is very rigid; the Senate bill has a bit more flexibility. We have argued unsuccessfully that various changes are needed to build more discretion into the system to determine whether, in the debtor's individual circumstances, they really have the capacity to repay (like the IRS has when it used the guidelines for tax collection). We also sought less stringent thresholds and various technical changes to prevent unfairness in the application of the test. Some provisions from each bill are better, but neither bill would address our fundamental concern. We expect a compromise with some of the better and worse features of each.

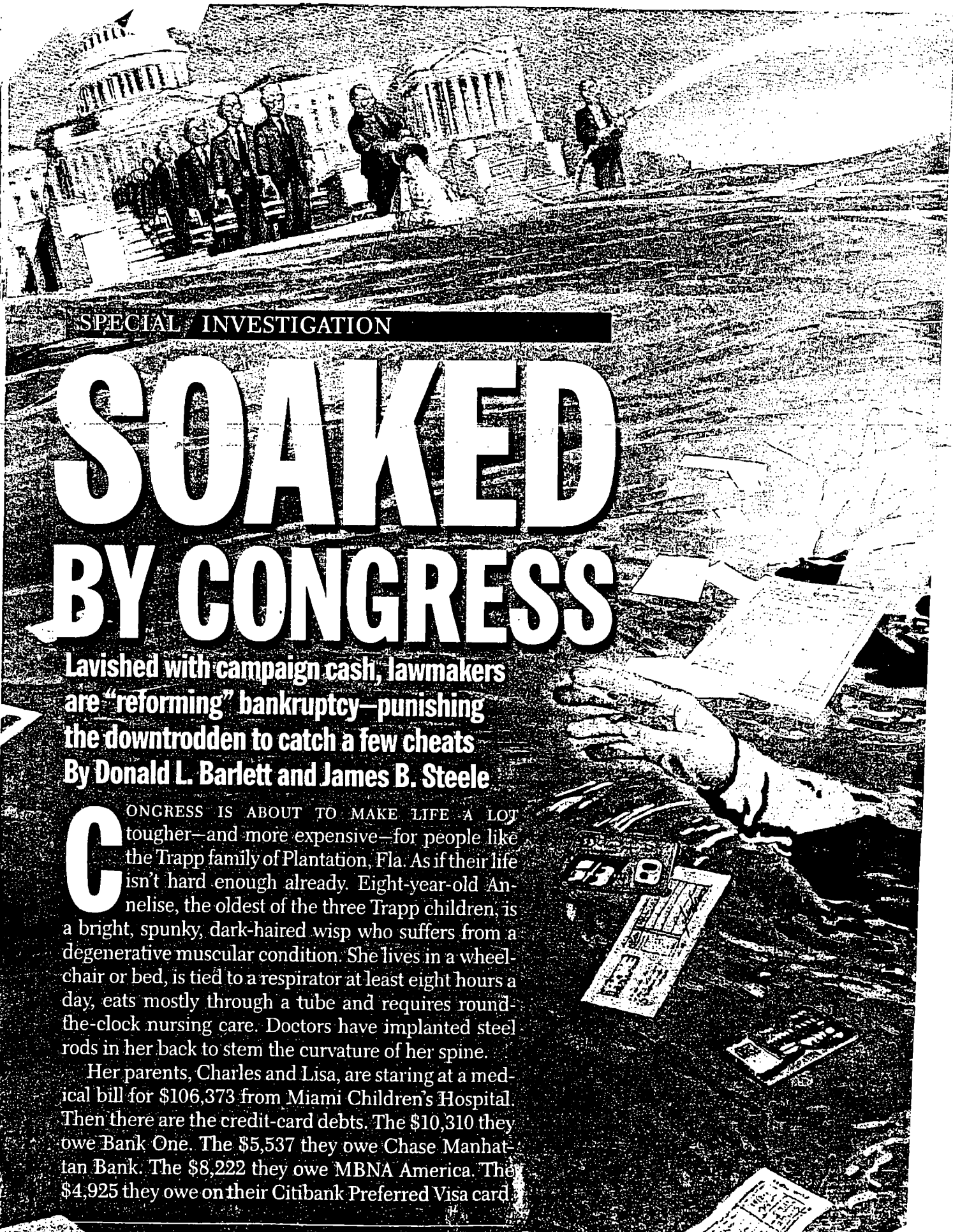
Protection of Child Support and Alimony: In the last Congress, the First Lady wrote of her concern with provisions that made additional credit card debt nondischargeable in bankruptcy, thus leaving it to compete with higher societal priorities that also are nondischargeable – especially payment of child support and alimony. In response, the bill's proponents added numerous provisions to clarify that child support and alimony are the highest priority. We believe that these provisions will work in many cases to improve the payment of child support and alimony in bankruptcy; however, in a small portion of cases after bankruptcy discharge, where there is no court supervision of child support and alimony payments or wage garnishment, these credit card debts could crowd out child support or alimony. Our argument is very technical; rhetorically, they have neutralized our criticism.

Debtor Protections Against Coercion: During bankruptcy, too many debtors are misled or tricked into agreeing to repay debts that they cannot afford and have a legal right to discharge. The Senate bill contains provisions that make it significantly more difficult to mislead or deceive debtors who cannot afford to reaffirm their debts, although the provisions could be significantly improved to strengthen the hand of debtors seeking remedies when the bill's requirements are not observed. (Certain consumer groups actually oppose the stronger Senate provisions, even though they would prevent many more abusive reaffirmations, because they also may provide creditors with new legal arguments in defending litigation.)

The House bill has far weaker provisions and, most notably, a ban on class actions when seeking remedy for abuse of these requirements. We expect the class action ban to be dropped and the Senate provisions to be retained largely intact, but without the desired improvements. If the class action ban is retained, newfound opposition to the bill may arise.

Clinic Violence: Recently, anti-abortion protesters have used personal bankruptcy to avoid penalties for violence against family planning clinics, some even strategically sending protestors who are judgment proof. Senator Schumer offered an amendment in the Senate that would make court-ordered and other debts resulting from such violence nondischargeable. We strongly supported the amendment. The Vice President was present in the Senate Chamber when they voted on the amendment to break a tie, if needed. To avoid embarrassment, Republicans urged their members to vote for the amendment and it passed by a vote of 80-17. The House has no comparable provision. In conference, they are expected to modify the amendment so that it covers debts from acts of violence generally, so they can avoid special protection for clinic violence debts. There may be technical flaws in their drafting of the broader amendment, so it will not protect all clinic-related debts. Abortion rights groups are not sure whether they want to fix these flaws, preferring to have the issue. If the Republicans drop the provision, Senate Democrats will likely rally; but if they simply broaden it to cover other violence, those eager to vote for the bill will likely concur.

Pension Benefit Protections: The Senate bill also included a provision that would allow debtors to waive in advance bankruptcy protections for certain retirement assets (IRAs and non-ERISA plans). Senator Grassley had earlier offered a provision that would have capped the pension assets that debtors could shield from creditors in bankruptcy, but facing labor opposition to that he instead opted for this. We fear that those of limited means and sophistication could be compelled (perhaps in the boilerplate of a credit card or loan application) to waive protections for the retirement assets. As awareness of this provision has grown, it has provoked a firestorm. We expect it to be modified or eliminated.



SPECIAL INVESTIGATION

SOAKED BY CONGRESS

Lavished with campaign cash, lawmakers are "reforming" bankruptcy—punishing the downtrodden to catch a few cheats

By Donald L. Barlett and James B. Steele

CONGRESS IS ABOUT TO MAKE LIFE A LOT tougher—and more expensive—for people like the Trapp family of Plantation, Fla. As if their life isn't hard enough already. Eight-year-old Annelise, the oldest of the three Trapp children, is a bright, spunky, dark-haired wisp who suffers from a degenerative muscular condition. She lives in a wheelchair or bed, is tied to a respirator at least eight hours a day, eats mostly through a tube and requires round-the-clock nursing care. Doctors have implanted steel rods in her back to stem the curvature of her spine.

Her parents, Charles and Lisa, are staring at a medical bill for \$106,373 from Miami Children's Hospital. Then there are the credit-card debts. The \$10,310 they owe Bank One. The \$5,537 they owe Chase Manhattan Bank. The \$8,222 they owe MBNA America. The \$4,925 they owe on their Citibank Preferred Visa card.

Illustration for TIME by C.F. Payne



BIG MONEY & POLITICS WHO GETS HURT?

The \$6,838 they owe on their Discover card. The \$6,458 they owe on their MasterCard. "People don't understand, unless they have a medically needy child, these kinds of circumstances," says Charles Trapp, 42, a mail carrier.

Why would Congress add to the burdens of folks like the Trapps? The family has filed for bankruptcy, and Congress wants to make it a lot more difficult for other Americans to do the same, a change that would hit especially hard at women. And poor people. And the recently jobless. And the sick.

Under legislation Congress is expected to take up soon, families like the Trapps will be required to go through a series of means tests to justify their medical and other expenses. That will cost them: more money in legal bills, more days lost from work, more mental aggravation. Even worse, in the end they still might not qualify for bankruptcy assistance.

Most members of Congress believe in what they are doing. Senator Charles Grassley, an Iowa Republican, speaks for many of his colleagues when he says, "I hope this bill does make bankruptcy more embarrassing—and more difficult. In fact, I plead guilty that that is a motive behind our legislation."

The House passed its version of the bankruptcy bill last year. The Senate enacted its bill in February. Now members of both chambers are meeting in secret to iron out differences and put their finishing touches on what they call the Bankruptcy Reform Act, which has the ostensible goal of curbing abuses.

What is the real reason Congress is doing this? Because the legislation is just what banks, credit-card companies, debt consolidators and other financial-services businesses ordered. To get it, they retained high-powered Washington lobbyists, among them Haley Barbour, former chairman of the Republican National Committee, and Lloyd Bentsen, onetime Senator and Treasury Secretary. The price tag for lobbying: more than \$5 million.

At the same time, the lending industry poured contributions into the coffers of the national committees of both political parties and into the campaigns of individual lawmakers whose support was crucial. Some of the giving was appropriately timed. A \$200,000 contribution to the National Republican Senatorial Committee by MBNA Corp.—which is to credit cards

what Pepsi is to soft drinks—was delivered on the day of an earlier House vote on the bankruptcy bill. It passed handily, 300 to 125. The price tag for political contributions: more than

\$20 million. Says a Capitol Hill staff member who worked on the bankruptcy legislation: "If this were NASCAR, the members would have to have the corporate logos of their sponsors sewn to their jackets."

The Bankruptcy Reform Act is typical of legislation that Congress writes for the benefit of special-interest groups that are hefty campaign contributors—at the expense of ordinary Americans who contribute nothing. The proposed legislation would treat a bankrupt man's credit-card debt the same as his obligation to pay child support, meaning that MasterCard and an unmarried mother would compete for the same limited pool of cash. And the law would create hurdles intended to discourage or prevent people from filing for bankruptcy protection.

If, for example, a bankruptcy filer was left with more than \$1,200 a year (beyond his basic expenses) over five years, that would be considered an abuse. If a mother tapped an ATM to buy necessities such as food or prescription drugs six weeks before filing for bankruptcy, the withdrawal could be considered a fraudulent transaction. If a family planned to file for bankruptcy, it would first have to undergo credit counseling, in some cases at its own expense. If a child or some other member of the family received medical treatment within 90 days before the bankruptcy filing, the bills could never be written off, no matter how poor the family.

To get into bankruptcy court, a filer would have to produce a variety of financial documents, including statements of projected monthly income and expected pay raises over the next year, and tax returns for the previous three years. No one of these requirements may look particularly onerous. But taken together, these and other provisions would impose additional burdens and legal costs on individuals and families already struggling to survive. "It's a thousand paper cuts," says Elizabeth Warren, a Harvard Law School professor and bankruptcy specialist. "And some people will bleed to death from a thousand paper cuts."

That includes people like the Trapps, who, after years of meeting their bills, were finally engulfed in a sea of debt through circumstances beyond their control. In that, they fit the classic image of a family seeking help in bankruptcy court. Contrary to the popular view of bankruptcy filers as free spenders who vacation in the Caribbean and buy expensive jewelry on their credit cards, the vast majority turn to bankruptcy court only after one of three events: loss of job, divorce or extraordinary medical expenses—in short, the kind of misfortune that can befall anyone. For the Trapps, it was two out of three. Just as

CASE NO. 1: MEDICAL BILLS

The Trapp Family

Charles and Lisa Trapp met as mail carriers in Plantation, Fla. When Annelise, 8, developed a muscular disorder, she needed round-the-clock nursing care. Lisa had to quit her job. With \$124,000 in doctor bills that insurance won't cover, paying off credit cards is the least of their worries. They've filed for Chapter 7 bankruptcy



Second in a series of
Investigative Reports
on campaign finance

BUNK UZZLE FOR TIME



the family was consumed by medical bills, Lisa Trapp had to give up her job as a mail carrier to manage her daughter's care.

Current bankruptcy law allows most individuals and families to file under Chapter 7. Here, assets—if there are any—are pulled together by a trustee and sold off. The bankruptcy filer may be able to keep his home and a few personal possessions. Retirement accounts and pensions also cannot be touched. Proceeds from the asset sale are divided among creditors. Outstanding debts, such as credit-card or medical bills, are discharged, meaning they do not have to be paid. Again there are certain exceptions: most taxes, child support, alimony and student loans cannot be discharged. Other individuals and families—those who are deemed able to pay back a larger portion of their debt—may file under Chapter 13. Here, the debtor agrees to pay a percentage of his income every month for up to five years to a trustee, who distributes the money to creditors.

During the 1990s, there were two filings under Chapter 7 for every one under Chapter 13. But the overwhelming majority of Chapter 13 bankruptcy cases ended in failure, with the debtors unable to complete the payment plan because they had insufficient income.

Under the legislation before Congress, new means tests would force more borrowers into Chapter 13—leading to still more failures—and would eliminate bankruptcy as an option for others. For this second group, life will be especially bleak. Listen to their future as described by Brady Williamson, who teaches constitutional law at the University of Wisconsin in Madison and was chairman of the former National Bankruptcy Review Commission, appointed by Congress in 1995: "A family without access to the bankruptcy system is subject to garnishment proceedings, to multiple collection actions, to repossession of personal property and to mortgage foreclosure. There is virtually no way to save their home and, for the family that does not own a home, no way to ever qualify to buy one." The wage earner will be "faced with what is essentially a life term in debtor's prison."

CASE NO. 2: JOB LOSS

Marilynn Curry

After 13 years with a Fayetteville, Ark., law firm, Curry lost her job as a secretary. The single mother found another job, but it pays \$15,000 less. Now she's in bankruptcy court

Personal bankruptcy filings ...

CHAPTER

7

of the Bankruptcy Code is for individuals unable to pay their debts. The trustee sells assets, if any, and turns the proceeds over to creditors. All remaining unsecured debts, like credit cards and medical bills, usually are canceled.

13

CHAPTER

of the Bankruptcy Code is for individuals who have income and can afford to pay at least a portion of their debts. Under a court-approved plan, debtors pay, for up to five years, a fixed monthly sum to the trustee, who distributes the money among creditors.

... affecting mainly the poor

The median characteristics of a person declaring Chapter 7 bankruptcy



Secured debt (car)
\$9,418

Miscellaneous debt (medical bills)
\$10,202

Unsecured debt (credit card)
\$23,190

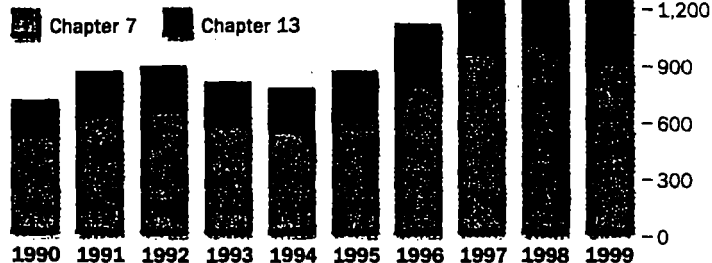
Source: Executive Office for United States Trustees



... climbed through most of the '90s

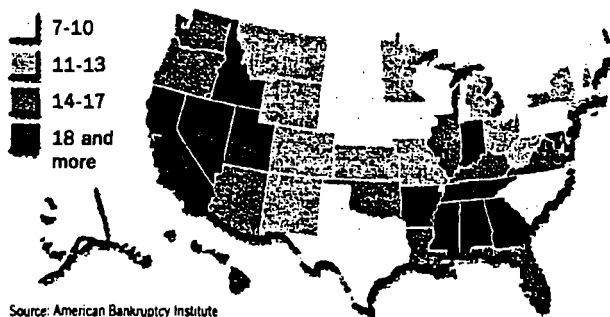
Personal Bankruptcies

In thousands



Source: American Bankruptcy Institute

Bankruptcies per 1,000 Households, 1998



Source: American Bankruptcy Institute

... and women

Who filed for bankruptcy in 1999

457,000 women

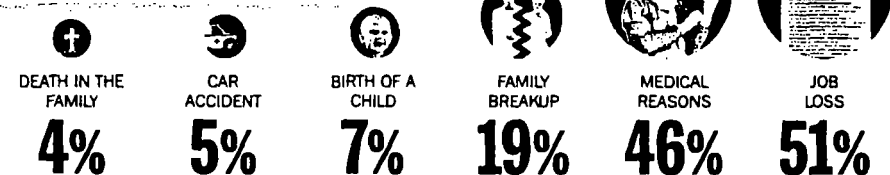
367,000 men

423,000 joint filings

Source: Consumer Bankruptcy Project

... for a variety of reasons

Some of the reasons given for bankruptcy filings (Respondents may have given more than one answer)



Source: Consumer Bankruptcy Project

TIME Graphic by Joe Zeff

How did this come about? The credit-card industry seized on a sharp increase in bankruptcy filings in 1996 and 1997 to mount an intensive lobbying campaign for legislation that would make it easier to collect from borrowers who file for bankruptcy. A sophisticated public-relations blitz created the image of a bankruptcy system rife with abuse and in need of reform. That campaign told of rich people walking away from their debts, courtesy of bankruptcy court. It told of responsible families who paid their bills being forced to pick up the costs of more affluent Americans and others who were bilking the system. And it warned that bankruptcy had lost its "stigma."

The industry bankrolled studies to back its claims. In February 1998 the WEFA Group, a Philadelphia-based economics consulting firm, released a report contending that personal bankruptcies cost each American household an average of \$400 a year. Paid for by MasterCard International and Visa USA, the WEFA study put the overall cost to the economy at \$44 billion in 1997. Said Mark Lauritano, a WEFA senior vice president: "Clearly, the American consumer is facing a significant burden as the result of bankruptcy, both through higher prices and increased interest rates." The dollar-cost claims—which

were disingenuous at best—would become the most widely quoted statistics in the campaign that produced the legislation now before Congress.

To apply pressure on lawmakers, the industry ran a series of ads in newspapers calling for bankruptcy reform. "What Do Bankruptcies Cost American Families?" asked a typical ad in the *Washington Post* on June 4, 1998. The answer: "A month's worth of groceries." Sponsored by a consortium of credit-industry trade associations, the ad showed a shopping cart filled with groceries. "Today's record number of personal bankruptcies costs every American family \$400 a year. Now Congress has an opportunity to enact bankruptcy reform that reduces this burden and is fair to everyone ... while ensuring that people who can pay their debts do so."

Other Visa- and MasterCard-financed studies asserted that many whose debts are discharged in bankruptcy could actually pay some of their bills but don't. The Credit Research Center at Georgetown University estimated that 25% of the debtors who file in Chapter 7 could repay more than 30% of their nonhousing debt over five years. The study warned that the continuing rise in bankruptcy filings would increase the cost of credit. It concluded: "Our results imply that the bankruptcy sys-

tem itself is contributing to these rising costs by offering the opportunity to wipe out debt with a single signature to many borrowers that have the ability to repay."

Industry lobbyists promoted the themes. George Wallace, a lawyer representing the American Financial Services Association, contended that there is "growing statistical evidence that there's a significant group of American consumers who are using bankruptcy when they have some ability to pay. We have a system today that is broken, a system that provides a welfare benefit without a means testing."

Members of Congress echoed the industry line. Declared Representative George Gekas, the Pennsylvania Republican who shepherded the legislation through the House (and who has collected \$30,000 in political contributions since 1997 from bankers and credit-card companies): "In 1997 Americans filed an all-time record of 1.33 million consumer-bankruptcy petitions, which erased an estimated \$40 billion in consumer debt. Those losses are passed on to [other] consumers, resulting in a hidden tax for every American household. The only reasonable explanation is that the stigma of bankruptcy is all but dead. It is simply too easy to file."

Representative Bill McCollum, a Florida Republican who has received

\$225,000 from the lending industry, upped the ante: "Bankruptcy will cost consumers more than \$50 billion in 1998 alone. That translates into more than \$550 per household in higher costs for goods, services and credit."

Senator Robert Torricelli of New Jersey, a strong advocate of the Senate bill and head of the Democratic Senatorial Campaign Committee, last year pocketed a \$150,000 contribution from MBNA. "What every American needs to understand is that somebody is paying the price," says Torricelli. "I believe this is the equivalent of an invisible tax on the American family, estimated to cost each and every American family \$400 a year."

There is only one problem with all this rhetoric: it's not true. That's the finding of a TIME investigation based on interviews with those directly involved in the system—judges, lawyers, trustees, bankruptcy professors and the bankrupt themselves—along with an examination of court records across the country and an array of statistical evidence. While lenders do indeed lose money on those who fail to pay their bills, the U.S. Bankruptcy Court maintains no statistics on the types of debt written off—credit cards, medical, personal loans—or the total dollar amount discharged. But whatever that number may be, it misses the point: there is little more to be extracted from those in bankruptcy. Some people unquestionably use bankruptcy court to escape bills they could afford to pay, but their numbers are insignificant. The vast majority of bankruptcy filers have neither the income nor the assets to pay creditors. Most turn to bankruptcy as a last resort.

To understand how much at odds with the real world the bankruptcy scene imagined by Congress and the lending industry is, spend a moment with the people who have a street-level view of the system. Steven Friedman, a bankruptcy judge in West Palm Beach, Fla., describes the people who pass through his courtroom as "average citizens who have worked hard to obtain a decent standard of living and, through unfortunate circumstances such as medical problems or financial or job loss, are down on their luck." He adds, "The instances of abuse, where people who file bankruptcy are attempting to defraud their creditors or to be dishonest, are very [few]."

Says attorney Judith Swift, a former president of the bankruptcy bar in Dallas: "I keep a box of tissues in my office because people are mortified that they have to file bankruptcy. I've seen grown men break down. They take the financial crises as a sign of personal failure. A lot of people who come to my office have been holding down one full-time job and two piddly little part-

MAKING THEIR PITCH: THE LENDERS' SIDE

STUDIES commissioned by credit-card companies—and cited by congressional supporters—contend that bankruptcy filers are dumping debts they could pay in taxpayers' laps



LOBBYISTS hired by the industry to push for tougher bankruptcy laws include **Lloyd Bentsen**, former Senator and Treasury Secretary, and **Haley Barbour**, former RNC chairman. The lobbying effort costs millions

CONTRIBUTIONS from banks, credit-card companies and other lenders since '97 totaled more than \$20 million. Both parties benefited

PAC/Soft-Money Contributions From Consumer Creditors

1997-99 totals

To Democrats	\$8.2 million
To Republicans	\$15.2 million

Who Gave Money in 1999 ...

LEADING DONORS—CONSUMER CREDITORS

MBNA Corp.	\$668,500
American Bankers Assn.	633,108
Credit Union Natl. Assn.	572,594
Citigroup Inc.	509,171
Bank of America Corp.	460,805

... And Who Got Money

LEADING HOUSE RECIPIENTS

Bill McCollum (R., Fla.)	\$88,499
Richard Baker (R., La.)	85,677
Rick Lazio (R., N.Y.)	85,500
Dennis Hastert (R., Ill.)	58,061
Marge Roukema (R., N.J.)	53,750

LEADING SENATE RECIPIENTS

Rod Grams (R., Minn.)	\$76,359
Robert Kenney (D., Neb.)	59,050
Rick Santorum (R., Pa.)	58,929
Spencer Abraham (R., Mich.)	55,369
Phil Gramm (R., Tex.)	51,417

Source: Common Cause

time jobs, trying frantically not to have to file a bankruptcy. It's a very, very difficult decision for most people."

It was for Maxean Bowen, a single mother raising an 11-year-old daughter. A social worker in the foster-care system in New York City, Bowen helped rehabilitate parents with substance-abuse problems. In 1998 she developed a painful condition in both feet that made it difficult for her to walk. Because her job required her to make house calls, she had to give it up and go on unemployment, hoping the condition would ease up. Her take-home pay dropped from about \$1,600 a month to \$800. To get by, she borrowed from relatives and started using credit cards to pay for food, clothing, utilities and rent. "I thought, 'As soon as I get back to work, I'll try to pay these off,'" she says.

By 1999, when she got a job interviewing families in an office, she owed thousands of dollars to the credit-card companies—much of it in late fees. That's when the threatening calls and letters surged. "They would call me on the job," she says. "That was very embarrassing. They call you early in the morning. They call you late at night. Sometimes I get calls at 10 o'clock at night. And they are very nasty." To placate them, she sent \$200 to \$300 on occasion. "But when the bill came the next month, it seemed like it went higher," she says. "I was going crazy."

A co-worker suggested bankruptcy, and Bowen filed a petition in U.S. Bankruptcy Court in New York. She still gets calls demanding payment. At least now, she says, she knows her creditors can't attach her salary, no matter how ugly the conversation turns.

Bowen's discovery that she was treading water despite her partial payments—and that the outstanding balance never went down—is not unusual. A government study showed that by the time individuals and families seek bankruptcy protection, more than 20% of income before taxes is going toward paying interest and fees on their unsecured debt.

This helps underscore why the notion that debtors in bankruptcy court are sitting on many billions of dollars that they could turn over to their creditors is a figment of the imagination of lenders and lawmakers. Consider:

■ A study of 1,955 Chapter 7 bankruptcy filers in 1997-98 by the Executive Office for U.S. Trustees, which monitors the bankruptcy system, concluded that "by the time they filed, they had little if any capacity to repay. In fact, most will have to increase income or reduce expenses to remain solvent after bankruptcy."

■ The same study projected that the to-

tal amount that unsecured creditors, like credit-card companies, might be expected to collect from all Chapter 7 filers added up to "less than \$1 billion annually."

■ A study by two law professors at Creighton University, funded by the non-partisan American Bankruptcy Institute, found that only 3.6% of Chapter 7 debtors would be able to pay more. "The vast majority belong in that chapter," the study stressed. "They have too little income after necessary expenses to repay unsecured debt. It is vital, therefore, that no undue burdens be thrust on that needy majority in order to flush out a small minority of abusers." The amount that might be collected: less than \$1 billion.

■ Congress's own investigative arm, the General Accounting Office, criticized two studies financed by the credit-card industry that purported to show that a substantial number of debtors could pay more. Questioning their assumptions, data and sampling procedures, the GAO said that "neither report provides reliable answers to the questions of how many debtors could make some repayment and how much debt they could repay."

As all of this suggests, there is little money to be squeezed out of those in bankruptcy, especially since trustees already collect about \$4 billion from debtors each year, a sum that includes proceeds from liquidated assets. Even if they could find an additional \$1 billion, the economic and emotional costs of doing so would far outweigh the return. To put it in perspective, the estimated \$1 billion that might be collected would amount to two-tenths of 1 percent-age point of outstanding revolving credit. If trustees were able to scare up another \$4 billion—as the industry claims but few in the bankruptcy system believe possible—it would still amount to less than seven-tenths of 1 percentage point of revolving credit.

To further undercut claims by the lending industry that it needs get-tough legislation, 82 professors at 66 law schools, from Harvard to UCLA, last September signed a letter itemizing the consequences the proposed bankruptcy legislation would have on those in need of financial relief. It was sent to every U.S. Senator.

What would motivate a sizable majority of Congress to support such legislation? Money. Lots of it. In addition to the \$5 million the lending industry spent on lobbyists who worked exclusively on pushing the

bankruptcy bill through Congress, it shelled out \$50 million that went to firms that lobbied on bankruptcy and other issues.

To be sure, some lawmakers who voted for the bill believe bankruptcy is out of control, that many filers just want to walk away from debts they can afford to pay. Some were angered by the procession of Hollywood entertainers and other wealthy prominent citizens who used the system in the 1990s. Some were annoyed by lawyers who advertised bankruptcy as an easy solution for overextended consumers. And some were troubled by what they saw as a decline in values. "We have had a general

middle-income filers, it has declined to put any curbs on practices of the financial industry that are leading many individuals deeper and deeper into debt. Beverly Fox, a bankruptcy lawyer in Plantation, told TIME: "[You] have a family with an annual gross combined income of \$35,000. I see they owe Citibank \$10,700. At the time Citibank gave them that credit limit, which is almost 33% of their annual gross income, Citibank looked at their credit report, or should have, and could see that they already owed three or four other credit cards \$3,000, to \$4,000, to \$5,000. They were already \$15,000 in debt, and the banks con-



STEVE WEINER FOR TIME

CASE NO. 3: DIVORCE

Martha Pouliot

Divorced after 18 years, Pouliot moved into a mobile home in Minnesota with her two sons. An office administrator, she couldn't pay the bills. In March she filed for bankruptcy, \$16,000 in debt.

lack of shame or personal responsibility that used to be associated with paying bills or not paying bills and the filing of bankruptcy," said Senator Grassley, who has collected more than \$100,000 in campaign contributions from credit-card companies and other lenders since 1997.

While the bill contains some genuine reforms, on balance the harm that it would do far outweighs the good. At the same time Congress has written legislation to make life more burdensome for low- and

continued to raise [the family's] credit limits because they are making the minimum payments. Once a family is over 30% debt-to-income ratio, it should stop using unsecured credit. But people don't know that. They think that because they've been approved for this higher credit limit, they can manage it." Because many people pay only the minimum amount due or a few dollars more, Fox says, they think everything is fine. But the balance on the cards "continues to grow, more as a result of the interest than the use of the cards."

Consumer advocates urged Congress to include in the legislation a provision requiring credit-card companies to spell out on each monthly statement the number of years it would take a cardholder to pay off the debt by making minimum payments, and how much that would cost overall. But that proposal went nowhere because it was opposed by the credit-card industry. The Senate version of the bill requires compa-



BIG MONEY & POLITICS WHO GETS HURT?

nies to include on monthly statements a toll-free number that cardholders can call to find out how long it would take them to pay off their loan.

Congress also turned back an amendment by Senator Paul Wellstone, a Minnesota Democrat, who proposed that lenders who charged more than 100% annual interest should be barred from collecting their debts in bankruptcy court. One-hundred percent interest? Actually, that's the bargain-basement rate. In some cases, interest rates run upwards of 1,000%.

Welcome to the world of payday lending, where annual interest rates would

times the value of the check, plus interest.

An Illinois study found the average annual interest rate for such services in that state was 533%. One customer was charged 2,007%.

Senator Orrin Hatch, a Utah Republican who has championed the bankruptcy legislation, defended payday loans. Said Hatch: "These lenders provide a vital service to the poorest borrowers. With this check-cashing service, borrowers can get the emergency cash they need without telling the boss they need a cash advance or giving up their televisions and furniture."

The burgeoning payday-loan industry includes publicly owned companies. Ace

Securities and Exchange Commission. Rose is the millionaire Dallas investor who helped George W. Bush turn a \$600,000 investment in the Texas Rangers baseball team into \$15 million—a 2,400% profit. Rose is one of the Bush Pioneers, the elite group of fund raisers who each promised to raise \$100,000 for the Texas Governor's presidential race.

While Rose has done quite nicely from his investments, customers of Ace Cash Express and other payday lenders have not fared nearly so well. As you might expect, people who pay interest charges of 300% or more often end up in bankruptcy court. Says David Nixon, a lawyer in



KEEPING THE HOME

James Villa



▲ When his brokerage went broke, Villa had lots of creditors. But Florida's homestead exemption keeps them off his \$1.4 million mansion

LOSING THE HOME

Allen Smith

► After his wife's death from diabetes, Smith faces losing his modest Delaware home. He fell behind on mortgage payments and other bills. Creditors will divide the proceeds from the sale of what little he has



make Mob loan sharks of an earlier era blush in embarrassment. The business flourishes in working-class neighborhoods, where people run out of money before their next payday. The lender may charge up to \$40 for a \$200 loan to be repaid in two weeks. That's an annual interest rate of 521%. In exchange for the advance, the lender requires the borrower to write a check for \$240, dated to coincide with his next paycheck. When the two weeks are up, the borrower may repay the loan or roll it over into a new one, further increasing the interest charges. If the borrower fails to do either, the lender cashes the post-dated check. If it bounces, the lender sues and in some states collects up to three

Cash Express, Inc., of Irving, Texas, operates more than 900 stores in 28 states and the District of Columbia where it cashes checks, sells lottery tickets and provides money-transfer and bill-paying services. At a third of its stores, Ace offers payday loans. Its stock is traded on the NASDAQ.

For a fee of \$30, Ace will advance cash for a \$200 check for two weeks. That works out to an annual rate of 391%. Income from the company's lending operations jumped from 7% of its total revenue in 1997 to 12% in 1999.

The company's largest stockholder is Edward ("Rusty") Rose III of Dallas. Rose owns 11% of Ace's outstanding stock, according to documents filed with the U.S.

Fayetteville, Ark.: "The kinds of people who use payday loans are just barely getting by. They have jobs. They work hard. They try to pay their bills, but they come up short. Here's an easy way to get cash fast—at least it seems easy. But it's like getting on a treadmill. Once they get on it, it's impossible to get off."

Sometimes the people on the treadmill aren't those you might expect. In Greenwood, Ind., one of Ace's customers was Eva Rowings, 60, a retired high school Latin teacher. In 1995 Rowings began teaching part time at a reduced salary. "I tried to make ends meet," she says, "and I did pretty well for a couple of years, but then it all went downhill." She had four operations,



including gall bladder surgery and orthoscopic procedures on both shoulders.

The debts piled up. She owed \$5,800 in medical bills, \$5,900 on credit cards and \$8,100 in loans, plus other miscellaneous bills. Her debts matched her total annual income.

She began borrowing at two other payday-lending firms before turning to Ace, where she was "astonished at the number of senior citizens that were coming in each month." In a typical transaction, she borrowed \$200 for 12 days and paid a \$30 fee—an annual interest rate of 456%. If she missed a payment, she says, she would owe an additional \$30. "By the end of the month," she says, "I would have no money." Finally, a distressed Rowings, who had always believed in paying her debts but was worn down by the endless dunning calls from bill collectors day and night, decided there was never going to be an end. She filed for bankruptcy. "It was humiliating," she says. "I wished I had never stopped teaching full time."

Another point should be noted. Rowings did not contribute to the election campaigns of candidates for Congress. Nor did Charles and Lisa Trapp. Nor Maxean Bowen. Their creditors, on the other hand, have contributed millions and millions of dollars to get the legislation they want—from thousands of small donations of less than \$5,000 to hundreds of large ones ranging from \$5,000 to more than a quarter-million dollars. Since 1997 credit-card companies and other lenders have given \$2.2 million to the House and Senate Judiciary Committee members responsible for drafting the legislation, according to data compiled by the Center for Responsive Politics.

While the industry got much of what it wanted, Congress thus far has sidestepped an opportunity to enact a genuine reform and end one of the most blatant bankruptcy inequities—the homestead provision.

If you live in a \$2 million home in Texas or Florida and file for bankruptcy, you are guaranteed you can keep your home. If you live in a \$75,000 home in Pennsylvania or Delaware and file for bankruptcy, you may lose it. How is this possible? People who file for bankruptcy claim their exemptions under state law. In the case of the homestead law, the provision varies from state to state. Five states—Florida, Iowa, Kansas, South Dakota and Texas—have unlimited exemptions. Whether a residence is worth \$10,000 or \$10 million, it can't be touched by creditors. Five other states—Delaware, Maryland, New Jersey, Pennsylvania and Rhode Island—along with the District of Columbia, have no homestead provision, meaning a person can lose his home in

bankruptcy. The value of the exemption in the remaining 40 states ranges from \$2,500 in Arkansas to \$200,000 in Minnesota.

Advocates of bankruptcy overhaul outside Congress have argued for years that federal law should be amended so that all Americans are treated alike, no matter where they live. But Congress doesn't see it that way. The reason? States' rights. Says

provisions. Neither deals with the basic unfairness of the exemption. The Senate bill would permit bankruptcy filers to retain up to \$100,000 in equity in their home. Any amount over that would go to creditors. The House bill would allow homeowners to retain up to \$250,000 in equity. But that cap would be meaningless, since any State could opt out of it under the bill. Key mem-

bers of Congress are on record as saying there will be no bill that limits the exemption.

To understand how the current system works, how it would work under "reform"—most likely the same—and how it should work if Congress were crafting a law that treated all people equally, let's consider the story of two homeowners in bankruptcy. One is James Villa, a 42-year-old onetime stockbroker who lives in a \$1.4 million home in Boca Raton, Fla. The other is Allen Smith, a 73-year-old retired autoworker with throat cancer who lives in a deteriorating \$80,000 home in Wilmington, Del.

Let's begin with Villa. Through most of the 1990s, he was president, chief executive officer and indirect owner of 99.5% of the stock of H.J. Meyers & Co., Inc., a brokerage firm based in Rochester, N.Y., with branch offices in more than a dozen cities. H.J. Meyers was a boiler room. Its most significant feature, according to an investigation by Massachusetts securities authorities, "was the high-pressure tactics of management continually exerted on brokers, who then used high-pressure tactics on their customers." Brokers cold-called people urging them to invest in speculative securities and initial public offerings underwritten by the firm. Brokers "implied to investors that they were in possession of important nonpublic information concerning an issuer."

One investor bought stock on his credit card after being assured that he would double his \$25,000 investment and that "nothing can go wrong." He didn't and it did. He lost \$15,000 and was forced to take out a home equity loan to cover his losses.

Villa profited handsomely from the business. For himself, he collected cigarette speedboats and vintage autos and



TON FOX/ARLINGTON MORNING NEWS

OUTRAGEOUS RATES

Edward Rose

Rose says of his investment in Ace Cash Express, a payday loan company. "I do not think we make an outrageous profit ... It's a valid service"



Senator Sam Brownback, a Kansas Republican: "What is being attempted here is to take a right away from states that they've had for over a hundred years. It's contrary to states' rights."

Not exactly. The Constitution expressly gives Congress the power to establish "uniform laws on the subject of bankruptcies throughout the United States." Both the House and Senate bills contain homestead



BIG MONEY & POLITICS WHO GETS HURT?

... racing cars, from a 1957 Cadillac to a 1990 Ferrari. For his wife, he collected jewelry—a \$22,000 Rolex watch, a three-carat \$44,000 wedding ring and \$9,000 diamond earrings.

In October 1998, Massachusetts securities authorities ruled that H.J. Meyers had engaged in fraudulent and unethical practices. They revoked the broker-dealer registrations of the firm, Villa and four of his associates. Shortly before the crack-down, H.J. Meyers closed its doors, and in November 1998 Villa packed up and headed for Florida and its generous homestead exemption. He left behind a countryside littered with investors who had lost money, including some whose retirement savings had disappeared. Some of the unlucky H.J. Meyers clients took their cases to arbitration, won awards and filed claims in Villa's bankruptcy case.

How much the creditors will eventually receive is up in the air. Charles Cohen, Villa's lawyer, says that "obviously, Mr. Villa is going to try to pay back everything he can. How much I can't tell you at this point." In the assets column, Villa's most valuable possession is his \$1.4 million Boca Raton home. But it's beyond the reach of his creditors, thanks to the homestead exemption.

By contrast, 1,100 miles to the north, in Wilmington, Del., 73-year-old Allen Smith is about to lose his home in bankruptcy court. Smith was born in Birmingham, Ala., and served in the Coast Guard during World War II. After his discharge in 1945, he attended an auto-mechanics school in Detroit and then went to work as a metal finisher and body repairman for Chrysler. The company transferred him to its Delaware plant in 1959, where he worked until he was forced out after 35 years during one of the automaker's downsizings.

Smith bought his modest home in Wilmington in 1964. In 1970, at age 44, he married. His wife Carolyn worked at a neighborhood florist. "I was living good, having a good time," Smith told TIME, "giving my wife everything she needed. Tried to make her happy."

When Smith lost his job at Chrysler in 1982, he was too young to collect Social Security so he took a new job as a security guard. Two years later, his world began to unravel. "Everything just went bad at one time. It waited until I got retired. If I had been working, it would have been different, but I had retired before everything started to happen."

"Everything" began with his wife's diabetes. "She just lost her toe in 1984," he says. Then "they had to cut her leg. And they had to keep cutting it off." Finally,

they amputated both legs. To accommodate her wheelchair, Smith built a ramp and made other renovations. To pay for it all and to keep up with the monthly payments on all his credit cards, he borrowed against his house, which had been paid off. "I had what they called triple-A credit," he says.

Along the way, Smith's physical condition deteriorated, and he had to quit his security job. He developed throat cancer and now speaks through a voice box. "I got sick," he says. "I got a thyroid [condition], cancer, low sugar, high blood pressure, heart murmur. I got everything. I'm lucky to be alive."

In June 1998 the Smiths filed a bankruptcy petition under Chapter 13, with the understanding they would make \$100

niece. "I wasn't planning to move," he says. "It hurts. I don't want to be nobody's responsibility because I've always been my own man all my life."

To create a level playing field for everyone, Congress would need to enact a flat exemption that covers all assets—from home to pension. Otherwise there is the kind of inequity described by A. Jay Cristol, the chief U.S. bankruptcy judge in Miami:

"Let's assume you have two very decent, honest people and one of them has a million-dollar home and one of them has a million dollars in cash and they go into bankruptcy. The one with the million-dollar home keeps a million bucks and the one with the million dollars in cash gives all but a thousand dollars in cash to the

TWO SIDES: THE CREDIT-CARD STORY *Invitation to Endless Debt*



THE TALK Bruce Hammonds, vice chairman and COO of MBNA America Bank, the world's third largest credit-card issuer, in testimony before a congressional committee:

“Card issuers use highly sophisticated and expensive ‘prescreening’ underwriting techniques, which involve consideration of as many as hundreds of factors about a consumer”

THE REALITY Solicitations bombard consumers daily, offering high credit limits no matter what their past credit history holds. Make basic payments and those limits rise



monthly payments to a trustee who would distribute the money to creditors. By that time, the loan against their home had swelled to \$64,000, and they owed \$51,000 on their credit cards and charge accounts, double their annual income. That November, Carolyn Smith died. With the loss of her Social Security income, Smith struggled. His situation was further complicated by a run of misfortune. He was hospitalized after a stroke; he had cataract surgery; the friend who promised to collect his pension and Social Security checks and make his mortgage payments didn't, and the mortgage company moved to foreclose. That's when his Chapter 13 case collapsed—as happens in two-thirds of all Chapter 13 proceedings—and he was switched to Chapter 7. Now he's awaiting his discharge. He will lose his home and move to Toledo, where he will live with a

The same scenario applies to retirement accounts. The wealthy investor who puts \$1 million into a retirement plan gets to keep the money. The middle-income family with \$10,000 in a savings account loses it.

The simple solution: Establish one exemption that covers all assets, from homesteads to pensions. Says Judge Cristol: "Why not just say you can have as a fresh start \$55,000 or \$100,000, or whatever the legislature decides is the right amount, and it doesn't make a difference if it's equity in your home or whether it's cash in the bank. That's what you get to keep. And that would be fairer and simpler, and the poorest people would be treated the same as the wealthiest people. But as it is now, the worse off you are, the worse you're treated."

Lenders and lawmakers maintain that the bankruptcy laws need to be toughened



to reverse the sharp growth in filings during the 1990s. While bankruptcy cases did indeed rise through 1998, they fell in 1999. But what Congress and credit-card companies neglected to say was that the increase was largely attributable to one group—women with modest or low incomes. For this group, reform is going to be especially bad.

Although courts do not keep data on the number of men, women and couples who file for bankruptcy, academic studies have developed estimates. Research conducted by Elizabeth Warren, a Harvard law professor, and Teresa Sullivan, dean of graduate studies at the University of Texas, shows the pattern. From 1981 to 1999, bankruptcy filings by women shot up 838%—four times as fast as for all others—jumping from 53,000 to 497,000. In contrast, filings by husbands and wives rose just 138%, from 178,000 to 423,000. Once a small minority in bankruptcy court, women now comprise the largest single bloc—33% of all personal-bankruptcy cases—more than men or couples.

Despite all the glowing economic indicators that point up—stock-market indexes, employment, corporate profits—the income gap continues to widen, and those most often found toward the bottom are women. Even women in jobs that pay solid middle-class wages find themselves in financial trouble and must seek bankruptcy protection when they are overwhelmed by debt following a breakup or a divorce.

Women such as Lucy Garcia. The 26-year-old mother of two boys, ages 9 and 6, Garcia is a payroll coordinator at the Sheraton New York, one of midtown Manhattan's largest hotels. Assigned to the food-and-beverage department, she helps compute wages, overtime payments and other payroll items for the department's 800 employees. And she balances the department's checkbook.

But in her personal life, balancing finances hasn't been easy since Garcia and her sons' father separated more than a year ago. Family finances had always been tight, and with just one paycheck, Garcia found herself using credit cards to buy the basics. "Sometimes when you don't have money and you need to buy things for your kids, like food and stuff like that, you use the credit card because it's so easy," she says.

After payroll deductions for taxes and Social Security, she had about \$1,850 a month to pay her bills. After her rent of \$580, a car loan of \$400 and an insurance premium of \$200, she was left with \$670 a month to feed and clothe the boys and herself and pay for her utilities, child care, other miscellaneous expenses—and her credit-card bills.

To bring the ballooning debt under control, she stopped using credit cards and made nominal payments on her accounts. "I thought if I sent them something, \$10 or \$20, they would leave me alone," she says. But she only fell further behind. Even in months when she didn't use the credit cards, the amount she owed rose because of late-payment penalties and interest charges. Before long, she needed to pay at least \$300 a month just to stay even.



CHRIS USHER FOR TIME

A VIEW FROM THE BENCH

Judge A. Jay Cristol

The colorful, outspoken chief U.S. bankruptcy judge in Miami sympathizes with the people who appear before him. "Day after day, we see decent, honest, hardworking people who have suffered one type or another of financial misfortune," says Cristol. "We also occasionally see the person trying to perpetrate a fraud. But in most instances the system deals with them. The problem is not in the evil debtors. It's in the stupidity of lending to people who are not creditworthy."

Unable to do so, she became increasingly short of cash and unable to pay her bills—rent, car, credit cards. She began alternating payments—the rent one month, credit cards the next, making a car payment after that. That didn't work either, and soon she was getting dunning letters and phone calls. One credit-card company threatened to attach her wages.

"It is just so frustrating to know you owe this much money," she says. "I wish I had the money to pay it off and be O.K.

I can't sleep at night. I have tried to not let it affect me with my children. Kids don't know. They say, 'Mommy, I want this.' 'Can we do that?' My God, if they only knew."

When she fell behind in the rent and her landlord warned that he would evict her, she knew she had to do something. She turned to a Manhattan consumer-bankruptcy lawyer, Charles Juntikka. Garcia was typical of many of his clients—embarrassed by her debts, upset over not being able to pay her bills, not knowing where to turn. "There is this image of middle-class people running up huge debts, then declaring bankruptcy and laughing at everyone," he says. "I've just never seen that. These people hurt."

Juntikka filed a petition for Garcia under Chapter 7, seeking to have her unsecured credit-card debt discharged. Garcia says she intends to give up the car to further reduce her debt load, and Juntikka is optimistic she will get a fresh start. Now, for the first time in months, Garcia says, she can sleep at night.

But if the Bankruptcy Reform Act pending in Congress were the law, Garcia would not be able to rest so easy. "Lucy wouldn't be able to obtain a discharge under this bill," says Juntikka. "Under the new standards Congress has put in the bill, she earns too much money. She could not get a discharge. She would still be stuck with some of the credit-card bills she can't pay now."

The standards referred to by Juntikka concern the means testing that allocates a fixed amount of expenses to debtors in computing their ability to pay their debts. And as Juntikka interprets them, Garcia would not be able to seek relief in Chapter 7. Even if by some chance she could prove her case in court, he says, the process would be lengthy and costly. "People aren't going to be able to deal with these draconian measures," he says. As a result, some people will be permanently indebted to credit-card companies, others will see their wages attached, some may lose their homes. "This is going to cause so much misery," he says.

Warren, the Harvard law professor and longtime student of bankruptcy, marvels at how a piece of legislation that could penalize so many people has come this far. "This is one of those things with low visibility, and therefore it's easy to give in to the interest group," says Warren. "It all flies below the radar screen. That's the best place for the lobbyists. That's where the pickings are the fattest. The only way to explain it is campaign contributions."

—With reporting by Laura Karmatz and Andrew Goldstein and research by Joan Levinstein

File is bankruptcy

SPECIAL INVESTIGATION

SOAKED BY CONGRESS

Lavished with campaign cash, lawmakers are "reforming" bankruptcy—punishing the downtrodden to catch a few cheats
By Donald L. Barlett and James B. Steele

CONGRESS IS ABOUT TO MAKE LIFE A LOT tougher—and more expensive—for people like the Trapp family of Plantation, Fla. As if their life isn't hard enough already. Eight-year-old Annelise, the oldest of the three Trapp children, is a bright, spunky, dark-haired wisp who suffers from a degenerative muscular condition. She lives in a wheelchair or bed, is tied to a respirator at least eight hours a day, eats mostly through a tube and requires round-the-clock nursing care. Doctors have implanted steel rods in her back to stem the curvature of her spine.

Her parents, Charles and Lisa, are staring at a medical bill for \$106,373 from Miami Children's Hospital. Then there are the credit-card debts. The \$10,310 they owe Bank One. The \$5,537 they owe Chase Manhattan Bank. The \$8,222 they owe MBNA America. The \$4,925 they owe on their Citibank Preferred Visa card.

Illustration for TIME by C.F. Payne

BIG MONEY & POLITICS WHO GETS HURT?

The \$6,838 they owe on their Discover card. The \$6,458 they owe on their MasterCard. "People don't understand, unless they have a medically needy child, these kinds of circumstances," says Charles Trapp, 42, a mail carrier.

Why would Congress add to the burdens of folks like the Trapps? The family has filed for bankruptcy, and Congress wants to make it a lot more difficult for other Americans to do the same, a change that would hit especially hard at women. And poor people. And the recently jobless. And the sick.

Under legislation Congress is expected to take up soon, families like the Trapps will be required to go through a series of means tests to justify their medical and other expenses. That will cost them: more money in legal bills, more days lost from work, more mental aggravation. Even worse, in the end they still might not qualify for bankruptcy assistance.

Most members of Congress believe in what they are doing. Senator Charles Grassley, an Iowa Republican, speaks for many of his colleagues when he says, "I hope this bill does make bankruptcy more embarrassing—and more difficult. In fact, I plead guilty that that is a motive behind our legislation."

The House passed its version of the bankruptcy bill last year. The Senate enacted its bill in February. Now members of both chambers are meeting in secret to iron out differences and put their finishing touches on what they call the Bankruptcy Reform Act, which has the ostensible goal of curbing abuses.

What is the real reason Congress is doing this? Because the legislation is just what banks, credit-card companies, debt consolidators and other financial-services businesses ordered. To get it, they retained high-powered Washington lobbyists, among them Haley Barbour, former chairman of the Republican National Committee, and Lloyd Bentsen, onetime Senator and Treasury Secretary. The price tag for lobbying: more than \$5 million.

At the same time, the lending industry poured contributions into the coffers of the national committees of both political parties and into the campaigns of individual lawmakers whose support was crucial. Some of the giving was appropriately timed. A \$200,000 contribution to the National Republican Senatorial Committee by MBNA Corp.—which is to credit cards what Pepsi is to soft drinks—was delivered on the day of an earlier House vote on the bankruptcy bill. It passed handily, 300 to 125. The price tag for political contributions: more than

\$20 million. Says a Capitol Hill staff member who worked on the bankruptcy legislation: "If this were NASCAR, the members would have to have the corporate logos of their sponsors sewn to their jackets."

The Bankruptcy Reform Act is typical of legislation that Congress writes for the benefit of special-interest groups that are hefty campaign contributors—at the expense of ordinary Americans who contribute nothing. The proposed legislation would treat a bankrupt man's credit-card debt the same as his obligation to pay child support, meaning that MasterCard and an unmarried mother would compete for the same limited pool of cash. And the law would create hurdles intended to discourage or prevent people from filing for bankruptcy protection.

If, for example, a bankruptcy filer was left with more than \$1,200 a year (beyond his basic expenses) over five years, that would be considered an abuse. If a mother tapped an ATM to buy necessities such as food or prescription drugs six weeks before filing for bankruptcy, the withdrawal could be considered a fraudulent transaction. If a family planned to file for bankruptcy, it would first have to undergo credit counseling, in some cases at its own expense. If a child or some other member of the family received medical treatment within 90 days before the bankruptcy filing, the bills could never be written off, no matter how poor the family.

To get into bankruptcy court, a filer would have to produce a variety of financial documents, including statements of projected monthly income and expected pay raises over the next year, and tax returns for the previous three years. No one of these requirements may look particularly onerous. But taken together, these and other provisions would impose additional burdens and legal costs on individuals and families already struggling to survive. "It's a thousand paper cuts," says Elizabeth Warren, a Harvard Law School professor and bankruptcy specialist. "And some people will bleed to death from a thousand paper cuts."

That includes people like the Trapps, who, after years of meeting their bills, were finally engulfed in a sea of debt through circumstances beyond their control. In that, they fit the classic image of a family seeking help in bankruptcy court. Contrary to the popular view of bankruptcy filers as free spenders who vacation in the Caribbean and buy expensive jewelry on their credit cards, the vast majority turn to bankruptcy court only after one of three events: loss of job, divorce or extraordinary medical expenses—in short, the kind of misfortune that can befall anyone. For the Trapps, it was two out of three. Just as

CASE NO. 1: MEDICAL BILLS

The Trapp Family

Charles and Lisa Trapp met as mail carriers in Plantation, Fla. When Annelise, 8, developed a muscular disorder, she needed round-the-clock nursing care. Lisa had to quit her job. With \$124,000 in doctor bills that insurance won't cover, paying off credit cards is the least of their worries. They've filed for Chapter 7 bankruptcy



Second in a series of
Investigative Reports
on campaign finance

BURK UZZLE FOR TIME



the family was consumed by medical bills, Lisa Trapp had to give up her job as a mail carrier to manage her daughter's care.

Current bankruptcy law allows most individuals and families to file under Chapter 7. Here, assets—if there are any—are pulled together by a trustee and sold off. The bankruptcy filer may be able to keep his home and a few personal possessions. Retirement accounts and pensions also cannot be touched. Proceeds from the asset sale are divided among creditors. Outstanding debts, such as credit-card or medical bills, are discharged, meaning they do not have to be paid. Again there are certain exceptions: most taxes, child support, alimony and student loans cannot be discharged. Other individuals and families—those who are deemed able to pay back a larger portion of their debt—may file under Chapter 13. Here, the debtor agrees to pay a percentage of his income every month for up to five years to a trustee, who distributes the money to creditors.

During the 1990s, there were two filings under Chapter 7 for every one under Chapter 13. But the overwhelming majority of Chapter 13 bankruptcy cases ended in failure, with the debtors unable to complete the payment plan because they had insufficient income.

Under the legislation before Congress, new means tests would force more borrowers into Chapter 13—leading to still more failures—and would eliminate bankruptcy as an option for others. For this second group, life will be especially bleak. Listen to their future as described by Brady Williamson, who teaches constitutional law at the University of Wisconsin in Madison and was chairman of the former National Bankruptcy Review Commission, appointed by Congress in 1995: "A family without access to the bankruptcy system is subject to garnishment proceedings, to multiple collection actions, to repossession of personal property and to mortgage foreclosure. There is virtually no way to save their home and, for the family that does not own a home, no way to ever qualify to buy one." The wage earner will be "faced with what is essentially a life term in debtor's prison."

CASE NO. 2: JOB LOSS

Marilynn Curry

After 13 years with a Fayetteville, Ark., law firm, Curry lost her job as a secretary. The single mother found another job, but it pays \$15,000 less. Now she's in bankruptcy court

Personal bankruptcy filings ...

CHAPTER 7

of the Bankruptcy Code is for individuals unable to pay their debts. The trustee sells assets, if any, and turns the proceeds over to creditors. **All remaining unsecured debts**, like credit cards and medical bills, usually **are canceled**.

CHAPTER 13

of the Bankruptcy Code is for individuals who have income and can afford to pay at least a portion of their debts. Under a court-approved plan, **debtors pay, for up to five years, a fixed monthly sum** to the trustee, who distributes the money among creditors.

... affecting mainly the poor

The median characteristics of a person declaring Chapter 7 bankruptcy



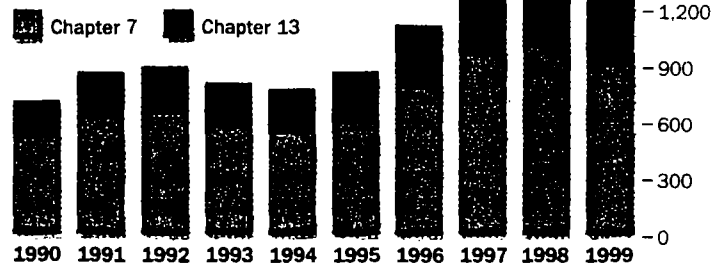
Source: Executive Office for United States Trustees



... climbed through most of the '90s

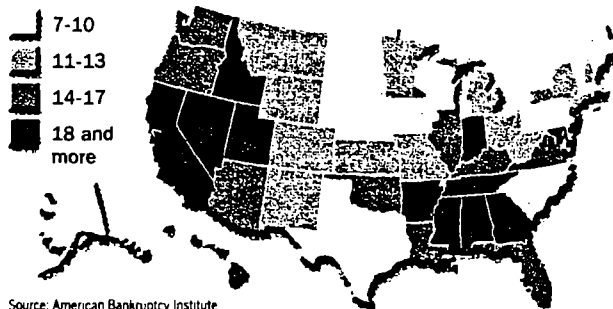
Personal Bankruptcies

In thousands



Source: American Bankruptcy Institute

Bankruptcies per 1,000 Households, 1998



Source: American Bankruptcy Institute

... and women

Who filed for bankruptcy in 1999

497,000 women

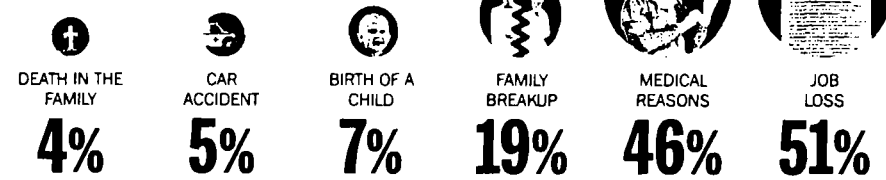
367,000 men

423,000 joint filings

Source: Consumer Bankruptcy Project

... for a variety of reasons

Some of the reasons given for bankruptcy filings (Respondents may have given more than one answer)



Source: Consumer Bankruptcy Project

TIME Graphic by Joe Zeff

How did this come about? The credit-card industry seized on a sharp increase in bankruptcy filings in 1996 and 1997 to mount an intensive lobbying campaign for legislation that would make it easier to collect from borrowers who file for bankruptcy. A sophisticated public-relations blitz created the image of a bankruptcy system rife with abuse and in need of reform. That campaign told of rich people walking away from their debts, courtesy of bankruptcy court. It told of responsible families who paid their bills being forced to pick up the costs of more affluent Americans and others who were bilking the system. And it warned that bankruptcy had lost its "stigma."

The industry bankrolled studies to back its claims. In February 1998 the WEFA Group, a Philadelphia-based economics consulting firm, released a report contending that personal bankruptcies cost each American household an average of \$400 a year. Paid for by MasterCard International and Visa USA, the WEFA study put the overall cost to the economy at \$44 billion in 1997. Said Mark Lauritano, a WEFA senior vice president: "Clearly, the American consumer is facing a significant burden as the result of bankruptcy, both through higher prices and increased interest rates." The dollar-cost claims—which

were disingenuous at best—would become the most widely quoted statistics in the campaign that produced the legislation now before Congress.

To apply pressure on lawmakers, the industry ran a series of ads in newspapers calling for bankruptcy reform. "What Do Bankruptcies Cost American Families?" asked a typical ad in the *Washington Post* on June 4, 1998. The answer: "A month's worth of groceries." Sponsored by a consortium of credit-industry trade associations, the ad showed a shopping cart filled with groceries. "Today's record number of personal bankruptcies costs every American family \$400 a year. Now Congress has an opportunity to enact bankruptcy reform that reduces this burden and is fair to everyone ... while ensuring that people who can pay their debts do so."

Other Visa- and MasterCard-financed studies asserted that many whose debts are discharged in bankruptcy could actually pay some of their bills but don't. The Credit Research Center at Georgetown University estimated that 25% of the debtors who file in Chapter 7 could repay more than 30% of their nonhousing debt over five years. The study warned that the continuing rise in bankruptcy filings would increase the cost of credit. It concluded: "Our results imply that the bankruptcy sys-

tem itself is contributing to these rising costs by offering the opportunity to wipe out debt with a single signature to many borrowers that have the ability to repay."

Industry lobbyists promoted the themes. George Wallace, a lawyer representing the American Financial Services Association, contended that there is "growing statistical evidence that there's a significant group of American consumers who are using bankruptcy when they have some ability to pay. We have a system today that is broken, a system that provides a welfare benefit without a means testing."

Members of Congress echoed the industry line. Declared Representative George Gekas, the Pennsylvania Republican who shepherded the legislation through the House (and who has collected \$30,000 in political contributions since 1997 from bankers and credit-card companies): "In 1997 Americans filed an all-time record of 1.33 million consumer-bankruptcy petitions, which erased an estimated \$40 billion in consumer debt. Those losses are passed on to [other] consumers, resulting in a hidden tax for every American household. The only reasonable explanation is that the stigma of bankruptcy is all but dead. It is simply too easy to file."

Representative Bill McCollum, a Florida Republican who has received

\$225,000 from the lending industry, upped the ante: "Bankruptcy will cost consumers more than \$50 billion in 1998 alone. That translates into more than \$550 per household in higher costs for goods, services and credit."

Senator Robert Torricelli of New Jersey, a strong advocate of the Senate bill and head of the Democratic Senatorial Campaign Committee, last year pocketed a \$150,000 contribution from MBNA. "What every American needs to understand is that somebody is paying the price," says Torricelli. "I believe this is the equivalent of an invisible tax on the American family, estimated to cost each and every American family \$400 a year."

There is only one problem with all this rhetoric: it's not true. That's the finding of a TIME investigation based on interviews with those directly involved in the system—judges, lawyers, trustees, bankruptcy professors and the bankrupt themselves—along with an examination of court records across the country and an array of statistical evidence. While lenders do indeed lose money on those who fail to pay their bills, the U.S. Bankruptcy Court maintains no statistics on the types of debt written off—credit cards, medical, personal loans—or the total dollar amount discharged. But whatever that number may be, it misses the point: there is little more to be extracted from those in bankruptcy. Some people unquestionably use bankruptcy court to escape bills they could afford to pay, but their numbers are insignificant. The vast majority of bankruptcy filers have neither the income nor the assets to pay creditors. Most turn to bankruptcy as a last resort.

To understand how much at odds with the real world the bankruptcy scene imagined by Congress and the lending industry is, spend a moment with the people who have a street-level view of the system. Steven Friedman, a bankruptcy judge in West Palm Beach, Fla., describes the people who pass through his courtroom as "average citizens who have worked hard to obtain a decent standard of living and, through unfortunate circumstances such as medical problems or financial or job loss, are down on their luck." He adds, "The instances of abuse, where people who file bankruptcy are attempting to defraud their creditors or to be dishonest, are very [few]."

Says attorney Judith Swift, a former president of the bankruptcy bar in Dallas: "I keep a box of tissues in my office because people are mortified that they have to file bankruptcy. I've seen grown men break down. They take the financial crises as a sign of personal failure. A lot of people who come to my office have been holding down one full-time job and two piddly little part-

MAKING THEIR PITCH: THE LENDERS' SIDE

STUDIES commissioned by credit-card companies—and cited by congressional supporters—contend that bankruptcy filers are dumping debts they could pay in taxpayers' laps



LOBBYISTS hired by the industry to push for tougher bankruptcy laws include **Lloyd Bentsen**, former Senator and Treasury Secretary, and **Haley Barbour**, former RNC chairman. The lobbying effort costs millions

CONTRIBUTIONS from banks, credit-card companies and other lenders since '97 totaled more than \$20 million. Both parties benefited

PAC/Soft-Money Contributions From Consumer Creditors

1997-99 totals

To Democrats \$8.2 million

To Republicans \$15.2 million

Who Gave Money in 1999 ...

LEADING DONORS—CONSUMER CREDITORS

MBNA Corp.	\$668,500
American Bankers Assn.	\$33,108
Credit Union Natl. Assn.	\$72,594
Citigroup Inc.	\$99,171
Bank of America Corp.	\$460,805

... And Who Got Money

LEADING HOUSE RECIPIENTS

Bill McCollum (R., Fla.)	\$88,499
Richard Baker (R., La.)	\$5,677
Rick Lazio (R., N.Y.)	\$5,500
Dennis Hastert (R., Ill.)	\$8,061
Marge Roukema (R., N.J.)	\$3,750

LEADING SENATE RECIPIENTS

Rod Grams (R., Minn.)	\$76,359
Robert Kerrey (D., Neb.)	\$9,050
Rick Santorum (R., Pa.)	\$8,929
Spencer Abraham (R., Mich.)	\$5,369
Phil Gramm (R., Tex.)	\$1,417

Source: Common Cause

time jobs, trying frantically not to have to file a bankruptcy. It's a very, very difficult decision for most people."

It was for Maxean Bowen, a single mother raising an 11-year-old daughter. A social worker in the foster-care system in New York City, Bowen helped rehabilitate parents with substance-abuse problems. In 1998 she developed a painful condition in both feet that made it difficult for her to walk. Because her job required her to make house calls, she had to give it up and go on unemployment, hoping the condition would ease up. Her take-home pay dropped from about \$1,600 a month to \$800. To get by, she borrowed from relatives and started using credit cards to pay for food, clothing, utilities and rent. "I thought, 'As soon as I get back to work, I'll try to pay these off,'" she says.

By 1999, when she got a job interviewing families in an office, she owed thousands of dollars to the credit-card companies—much of it in late fees. That's when the threatening calls and letters surged. "They would call me on the job," she says. "That was very embarrassing. They call you early in the morning. They call you late at night. Sometimes I get calls at 10 o'clock at night. And they are very nasty." To placate them, she sent \$200 to \$300 on occasion. "But when the bill came the next month, it seemed like it went higher," she says. "I was going crazy."

A co-worker suggested bankruptcy, and Bowen filed a petition in U.S. Bankruptcy Court in New York. She still gets calls demanding payment. At least now, she says, she knows her creditors can't attach her salary, no matter how ugly the conversation turns.

Bowen's discovery that she was treading water despite her partial payments—and that the outstanding balance never went down—is not unusual. A government study showed that by the time individuals and families seek bankruptcy protection, more than 20% of income before taxes is going toward paying interest and fees on their unsecured debt.

This helps underscore why the notion that debtors in bankruptcy court are sitting on many billions of dollars that they could turn over to their creditors is a figment of the imagination of lenders and lawmakers. Consider:

■ A study of 1,955 Chapter 7 bankruptcy filers in 1997-98 by the Executive Office for U.S. Trustees, which monitors the bankruptcy system, concluded that "by the time they filed, they had little if any capacity to repay. In fact, most will have to increase income or reduce expenses to remain solvent after bankruptcy."

■ The same study projected that the to-

tal amount that unsecured creditors, like credit-card companies, might be expected to collect from all Chapter 7 filers added up to "less than \$1 billion annually."

■ A study by two law professors at Creighton University, funded by the non-partisan American Bankruptcy Institute, found that only 3.6% of Chapter 7 debtors would be able to pay more. "The vast majority belong in that chapter," the study stressed. "They have too little income after necessary expenses to repay unsecured debt. It is vital, therefore, that no undue burdens be thrust on that needy majority in order to flush out a small minority of abusers." The amount that might be collected: less than \$1 billion.

■ Congress's own investigative arm, the General Accounting Office, criticized two studies financed by the credit-card industry that purported to show that a substantial number of debtors could pay more. Questioning their assumptions, data and sampling procedures, the GAO said that "neither report provides reliable answers to the questions of how many debtors could make some repayment and how much debt they could repay."

As all of this suggests, there is little money to be squeezed out of those in bankruptcy, especially since trustees already collect about \$4 billion from debtors each year, a sum that includes proceeds from liquidated assets. Even if they could find an additional \$1 billion, the economic and emotional costs of doing so would far outweigh the return. To put it in perspective, the estimated \$1 billion that might be collected would amount to two-tenths of 1 percentage point of outstanding revolving credit. If trustees were able to scare up another \$4 billion—as the industry claims but few in the bankruptcy system believe possible—it would still amount to less than seven-tenths of 1 percentage point of revolving credit.

To further undercut claims by the lending industry that it needs get-tough legislation, 82 professors at 66 law schools, from Harvard to UCLA, last September signed a letter itemizing the consequences the proposed bankruptcy legislation would have on those in need of financial relief. It was sent to every U.S. Senator.

What would motivate a sizable majority of Congress to support such legislation? Money. Lots of it. In addition to the \$5 million the lending industry spent on lobbyists who worked exclusively on pushing the

bankruptcy bill through Congress, it shelled out \$50 million that went to firms that lobbied on bankruptcy and other issues.

To be sure, some lawmakers who voted for the bill believe bankruptcy is out of control, that many filers just want to walk away from debts they can afford to pay. Some were angered by the procession of Hollywood entertainers and other wealthy prominent citizens who used the system in the 1990s. Some were annoyed by lawyers who advertised bankruptcy as an easy solution for overextended consumers. And some were troubled by what they saw as a decline in values. "We have had a general

middle-income filers, it has declined to put any curbs on practices of the financial industry that are leading many individuals deeper and deeper into debt. Beverly Fox, a bankruptcy lawyer in Plantation, told TIME: "[You] have a family with an annual gross combined income of \$35,000. I see they owe Citibank \$10,700. At the time Citibank gave them that credit limit, which is almost 33% of their annual gross income, Citibank looked at their credit report, or should have, and could see that they already owed three or four other credit cards \$3,000, to \$4,000, to \$5,000. They were already \$15,000 in debt, and the banks con-



STEVE WEINER FOR TIME

CASE NO. 3: DIVORCE

Martha Pouliot

Divorced after 18 years, Pouliot moved into a mobile home in Minnesota with her two sons. An office administrator, she couldn't pay the bills. In March she filed for bankruptcy, \$16,000 in debt

lack of shame or personal responsibility that used to be associated with paying bills or not paying bills and the filing of bankruptcy," said Senator Grassley, who has collected more than \$100,000 in campaign contributions from credit-card companies and other lenders since 1997.

While the bill contains some genuine reforms, on balance the harm that it would do far outweighs the good. At the same time Congress has written legislation to make life more burdensome for low- and

tinued to raise [the family's] credit limits because they are making the minimum payments. Once a family is over 30% debt-to-income ratio, it should stop using unsecured credit. But people don't know that. They think that because they've been approved for this higher credit limit, they can manage it." Because many people pay only the minimum amount due or a few dollars more, Fox says, they think everything is fine. But the balance on the cards "continues to grow, more as a result of the interest than the use of the cards."

Consumer advocates urged Congress to include in the legislation a provision requiring credit-card companies to spell out on each monthly statement the number of years it would take a cardholder to pay off the debt by making minimum payments, and how much that would cost overall. But that proposal went nowhere because it was opposed by the credit-card industry. The Senate version of the bill requires compa-

BIG MONEY & POLITICS WHO GETS HURT?

nies to include on monthly statements a toll-free number that cardholders can call to find out how long it would take them to pay off their loan.

Congress also turned back an amendment by Senator Paul Wellstone, a Minnesota Democrat, who proposed that lenders who charged more than 100% annual interest should be barred from collecting their debts in bankruptcy court. One-hundred percent interest? Actually, that's the bargain-basement rate. In some cases, interest rates run upwards of 1,000%.

Welcome to the world of payday lending, where annual interest rates would

times the value of the check, plus interest.

An Illinois study found the average annual interest rate for such services in that state was 533%. One customer was charged 2,007%.

Senator Orrin Hatch, a Utah Republican who has championed the bankruptcy legislation, defended payday loans. Said Hatch: "These lenders provide a vital service to the poorest borrowers. With this check-cashing service, borrowers can get the emergency cash they need without telling the boss they need a cash advance or giving up their televisions and furniture."

The burgeoning payday-loan industry includes publicly owned companies. Ace

Securities and Exchange Commission. Rose is the millionaire Dallas investor who helped George W. Bush turn a \$600,000 investment in the Texas Rangers baseball team into \$15 million—a 2,400% profit. Rose is one of the Bush Pioneers, the elite group of fund raisers who each promised to raise \$100,000 for the Texas Governor's presidential race.

While Rose has done quite nicely from his investments, customers of Ace Cash Express and other payday lenders have not fared nearly so well. As you might expect, people who pay interest charges of 300% or more often end up in bankruptcy court. Says David Nixon, a lawyer in



KEEPING THE HOME

James Villa



▲ When his brokerage went broke, Villa had lots of creditors. But Florida's homestead exemption keeps them off his \$1.4 million mansion

LOSING THE HOME

Allen Smith

► After his wife's death from diabetes, Smith faces losing his modest Delaware home. He fell behind on mortgage payments and other bills. Creditors will divide the proceeds from the sale of what little he has



make Mob loan sharks of an earlier era blush in embarrassment. The business flourishes in working-class neighborhoods, where people run out of money before their next payday. The lender may charge up to \$40 for a \$200 loan to be repaid in two weeks. That's an annual interest rate of 521%. In exchange for the advance, the lender requires the borrower to write a check for \$240, dated to coincide with his next paycheck. When the two weeks are up, the borrower may repay the loan or roll it over into a new one, further increasing the interest charges. If the borrower fails to do either, the lender cashes the post-dated check. If it bounces, the lender sues and in some states collects up to three

Cash Express, Inc., of Irving, Texas, operates more than 900 stores in 28 states and the District of Columbia where it cashes checks, sells lottery tickets and provides money-transfer and bill-paying services. At a third of its stores, Ace offers payday loans. Its stock is traded on the NASDAQ.

For a fee of \$30, Ace will advance cash for a \$200 check for two weeks. That works out to an annual rate of 391%. Income from the company's lending operations jumped from 7% of its total revenue in 1997 to 12% in 1999.

The company's largest stockholder is Edward ("Rusty") Rose III of Dallas. Rose owns 11% of Ace's outstanding stock, according to documents filed with the U.S.

Fayetteville, Ark.: "The kinds of people who use payday loans are just barely getting by. They have jobs. They work hard. They try to pay their bills, but they come up short. Here's an easy way to get cash fast—at least it seems easy. But it's like getting on a treadmill. Once they get on it, it's impossible to get off."

Sometimes the people on the treadmill aren't those you might expect. In Greenwood, Ind., one of Ace's customers was Eva Rowings, 60, a retired high school Latin teacher. In 1995 Rowings began teaching part time at a reduced salary. "I tried to make ends meet," she says, "and I did pretty well for a couple of years, but then it all went downhill." She had four operations,



including gall bladder surgery and orthoscopic procedures on both shoulders.

The debts piled up. She owed \$5,800 in medical bills, \$5,900 on credit cards and \$8,100 in loans, plus other miscellaneous bills. Her debts matched her total annual income.

She began borrowing at two other payday-lending firms before turning to Ace, where she was "astonished at the number of senior citizens that were coming in each month." In a typical transaction, she borrowed \$200 for 12 days and paid a \$30 fee—an annual interest rate of 456%. If she missed a payment, she says, she would owe an additional \$30. "By the end of the month," she says, "I would have no money." Finally, a distressed Rowings, who had always believed in paying her debts but was worn down by the endless dunning calls from bill collectors day and night, decided there was never going to be an end. She filed for bankruptcy. "It was humiliating," she says. "I wished I had never stopped teaching full time."

Another point should be noted. Rowings did not contribute to the election campaigns of candidates for Congress. Nor did Charles and Lisa Trapp. Nor Maxean Bowen. Their creditors, on the other hand, have contributed millions and millions of dollars to get the legislation they want—from thousands of small donations of less than \$5,000 to hundreds of large ones ranging from \$5,000 to more than a quarter-million dollars. Since 1997 credit-card companies and other lenders have given \$2.2 million to the House and Senate Judiciary Committee members responsible for drafting the legislation, according to data compiled by the Center for Responsive Politics.

While the industry got much of what it wanted, Congress thus far has sidestepped an opportunity to enact a genuine reform and end one of the most blatant bankruptcy inequities—the homestead provision.

If you live in a \$2 million home in Texas or Florida and file for bankruptcy, you are guaranteed you can keep your home. If you live in a \$75,000 home in Pennsylvania or Delaware and file for bankruptcy, you may lose it. How is this possible? People who file for bankruptcy claim their exemptions under state law. In the case of the homestead law, the provision varies from state to state. Five states—Florida, Iowa, Kansas, South Dakota and Texas—have unlimited exemptions. Whether a residence is worth \$10,000 or \$10 million, it can't be touched by creditors. Five other states—Delaware, Maryland, New Jersey, Pennsylvania and Rhode Island—along with the District of Columbia, have no homestead provision, meaning a person can lose his home in

bankruptcy. The value of the exemption in the remaining 40 states ranges from \$2,500 in Arkansas to \$200,000 in Minnesota.

Advocates of bankruptcy overhaul outside Congress have argued for years that federal law should be amended so that all Americans are treated alike, no matter where they live. But Congress doesn't see it that way. The reason? States' rights. Says

provisions. Neither deals with the basic unfairness of the exemption. The Senate bill would permit bankruptcy filers to retain up to \$100,000 in equity in their home. Any amount over that would go to creditors. The House bill would allow homeowners to retain up to \$250,000 in equity. But that cap would be meaningless, since any state could opt out of it under the bill. Key members of Congress are on record as saying there will be no bill that limits the exemption.

Tom Fox—Allington Morning News

To understand how the current system works, how it would work under "reform"—most likely the same—and how it should work if Congress were crafting a law that treated all people equally, let's consider the story of two homeowners in bankruptcy. One is James Villa, a 42-year-old onetime stockbroker who lives in a \$1.4 million home in Boca Raton, Fla. The other is Allen Smith, a 73-year-old retired autoworker with throat cancer who lives in a deteriorating \$80,000 home in Wilmington, Del.

Let's begin with Villa. Through most of the 1990s, he was president, chief executive officer and indirect owner of 99.5% of the stock of H.J. Meyers & Co., Inc., a brokerage firm based in Rochester, N.Y., with branch offices in more than a dozen cities. H.J. Meyers was a boiler room. Its most significant feature, according to an investigation by Massachusetts securities authorities, "was the high-pressure tactics of management continually exerted on brokers, who then used high-pressure tactics on their customers." Brokers cold-called people urging them to invest in speculative securities and initial public offerings underwritten by the firm. Brokers "implied to investors that they were in possession of important nonpublic information concerning an issuer."

One investor bought stock on his credit card after being assured that he would double his \$25,000 investment and that "nothing can go wrong." He didn't and it did. He lost \$15,000 and was forced to take out a home equity loan to cover his losses.

Villa profited handsomely from the business. For himself, he collected cigarette speedboats and vintage autos and



OUTRAGEOUS RATES

Edward Rose

Rose says of his investment in Ace Cash Express, a payday loan company. "I do not think we make an outrageous profit ... It's a valid service"



CHRIS USHER FOR TIME

Senator Sam Brownback, a Kansas Republican: "What is being attempted here is to take a right away from states that they've had for over a hundred years. It's contrary to states' rights."

Not exactly. The Constitution expressly gives Congress the power to establish "uniform laws on the subject of bankruptcies throughout the United States." Both the House and Senate bills contain homestead



BIG MONEY & POLITICS WHO GETS HURT?

...racing cars, from a 1957 Cadillac to a 1990 Ferrari. For his wife, he collected jewelry—a \$22,000 Rolex watch, a three-carat \$44,000 wedding ring and \$9,000 diamond earrings.

In October 1998, Massachusetts securities authorities ruled that H.J. Meyers had engaged in fraudulent and unethical practices. They revoked the broker-dealer registrations of the firm, Villa and four of his associates. Shortly before the crack-down, H.J. Meyers closed its doors, and in November 1998 Villa packed up and headed for Florida and its generous homestead exemption. He left behind a countryside littered with investors who had lost money, including some whose retirement savings had disappeared. Some of the unlucky H.J. Meyers clients took their cases to arbitration, won awards and filed claims in Villa's bankruptcy case.

How much the creditors will eventually receive is up in the air. Charles Cohen, Villa's lawyer, says that "obviously, Mr. Villa is going to try to pay back everything he can. How much I can't tell you at this point." In the assets column, Villa's most valuable possession is his \$1.4 million Boca Raton home. But it's beyond the reach of his creditors, thanks to the homestead exemption.

By contrast, 1,100 miles to the north, in Wilmington, Del., 73-year-old Allen Smith is about to lose his home in bankruptcy court. Smith was born in Birmingham, Ala., and served in the Coast Guard during World War II. After his discharge in 1945, he attended an auto-mechanics school in Detroit and then went to work as a metal finisher and body repairman for Chrysler. The company transferred him to its Delaware plant in 1959, where he worked until he was forced out after 35 years during one of the automaker's downsizings.

Smith bought his modest home in Wilmington in 1964. In 1970, at age 44, he married. His wife Carolyn worked at a neighborhood florist. "I was living good, having a good time," Smith told TIME, "giving my wife everything she needed. Tried to make her happy."

When Smith lost his job at Chrysler in 1982, he was too young to collect Social Security so he took a new job as a security guard. Two years later, his world began to unravel. "Everything just went bad at one time. It waited until I got retired. If I had been working, it would have been different, but I had retired before everything started to happen."

"Everything" began with his wife's diabetes. "She just lost her toe in 1984," he says. Then "they had to cut her leg. And they had to keep cutting it off." Finally,

they amputated both legs. To accommodate her wheelchair, Smith built a ramp and made other renovations. To pay for it all and to keep up with the monthly payments on all his credit cards, he borrowed against his house, which had been paid off. "I had what they called triple-A credit," he says.

Along the way, Smith's physical condition deteriorated, and he had to quit his security job. He developed throat cancer and now speaks through a voice box. "I got sick," he says. "I got a thyroid [condition], cancer, low sugar, high blood pressure, heart murmur. I got everything. I'm lucky to be alive."

In June 1998 the Smiths filed a bankruptcy petition under Chapter 13, with the understanding they would make \$100

niece. "I wasn't planning to move," he says. "It hurts. I don't want to be nobody's responsibility because I've always been my own man all my life."

To create a level playing field for everyone, Congress would need to enact a flat exemption that covers all assets—from home to pension. Otherwise there is the kind of inequity described by A. Jay Cristol, the chief U.S. bankruptcy judge in Miami:

"Let's assume you have two very decent, honest people and one of them has a million-dollar home and one of them has a million dollars in cash and they go into bankruptcy. The one with the million-dollar home keeps a million bucks and the one with the million dollars in cash gives all but a thousand dollars in cash to the trustee."

TWO SIDES: THE CREDIT-CARD STORY

Invitation to Endless Debt



THE TALK Bruce Hammonds, vice chairman and COO of MBNA America Bank, the world's third largest credit-card issuer, in testimony before a congressional committee:

THE REALITY Solicitations bombard consumers daily, offering high credit limits no matter what their past credit history holds. Make basic payments and those limits rise

“Card issuers use highly sophisticated and expensive ‘prescreening’ underwriting techniques, which involve consideration of as many as hundreds of factors about a consumer”



monthly payments to a trustee who would distribute the money to creditors. By that time, the loan against their home had swelled to \$64,000, and they owed \$51,000 on their credit cards and charge accounts, double their annual income. That November, Carolyn Smith died. With the loss of her Social Security income, Smith struggled. His situation was further complicated by a run of misfortune. He was hospitalized after a stroke; he had cataract surgery; the friend who promised to collect his pension and Social Security checks and make his mortgage payments didn't, and the mortgage company moved to foreclose. That's when his Chapter 13 case collapsed—as happens in two-thirds of all Chapter 13 proceedings—and he was switched to Chapter 7. Now he's awaiting his discharge. He will lose his home and move to Toledo, where he will live with a

The same scenario applies to retirement accounts. The wealthy investor who puts \$1 million into a retirement plan gets to keep the money. The middle-income family with \$10,000 in a savings account loses it.

The simple solution: Establish one exemption that covers all assets, from homesteads to pensions. Says Judge Cristol: "Why not just say you can have as a fresh start \$55,000 or \$100,000, or whatever the legislature decides is the right amount, and it doesn't make a difference if it's equity in your home or whether it's cash in the bank. That's what you get to keep. And that would be fairer and simpler, and the poorest people would be treated the same as the wealthiest people. But as it is now, the worse off you are, the worse you're treated."

Lenders and lawmakers maintain that the bankruptcy laws need to be toughened



to reverse the sharp growth in filings during the 1990s. While bankruptcy cases did indeed rise through 1998, they fell in 1999. But what Congress and credit-card companies neglected to say was that the increase was largely attributable to one group—women with modest or low incomes. For this group, reform is going to be especially bad.

Although courts do not keep data on the number of men, women and couples who file for bankruptcy, academic studies have developed estimates. Research conducted by Elizabeth Warren, a Harvard law professor, and Teresa Sullivan, dean of graduate studies at the University of Texas, shows the pattern. From 1981 to 1999, bankruptcy filings by women shot up 838%—four times as fast as for all others—jumping from 53,000 to 497,000. In contrast, filings by husbands and wives rose just 138%, from 178,000 to 423,000. Once a small minority in bankruptcy court, women now comprise the largest single bloc—39% of all personal-bankruptcy cases—more than men or couples.

Despite all the glowing economic indicators that point up—stock-market indexes, employment, corporate profits—the income gap continues to widen, and those most often found toward the bottom are women. Even women in jobs that pay solid middle-class wages find themselves in financial trouble and must seek bankruptcy protection when they are overwhelmed by debt following a breakup or a divorce.

Women such as Lucy Garcia. The 26-year-old mother of two boys, ages 9 and 6, Garcia is a payroll coordinator at the Sheraton New York, one of midtown Manhattan's largest hotels. Assigned to the food-and-beverage department, she helps compute wages, overtime payments and other payroll items for the department's 800 employees. And she balances the department's checkbook.

But in her personal life, balancing finances hasn't been easy since Garcia and her sons' father separated more than a year ago. Family finances had always been tight, and with just one paycheck, Garcia found herself using credit cards to buy the basics. "Sometimes when you don't have money and you need to buy things for your kids, like food and stuff like that, you use the credit card because it's so easy," she says.

After payroll deductions for taxes and Social Security, she had about \$1,850 a month to pay her bills. After her rent of \$580, a car loan of \$400 and an insurance premium of \$200, she was left with \$670 a month to feed and clothe the boys and herself and pay for her utilities, child care, other miscellaneous expenses—and her credit-card bills.

To bring the ballooning debt under control, she stopped using credit cards and made nominal payments on her accounts. "I thought if I sent them something, \$10 or \$20, they would leave me alone," she says. But she only fell further behind. Even in months when she didn't use the credit cards, the amount she owed rose because of late-payment penalties and interest charges. Before long, she needed to pay at least \$300 a month just to stay even.



CHRIS USHER FOR TIME

A VIEW FROM THE BENCH

Judge A. Jay Cristol

The colorful, outspoken chief U.S. bankruptcy judge in Miami sympathizes with the people who appear before him. "Day after day, we see decent, honest, hardworking people who have suffered one type or another of financial misfortune," says Cristol. "We also occasionally see the person trying to perpetrate a fraud. But in most instances the system deals with them. The problem is not in the evil debtors. It's in the stupidity of lending to people who are not creditworthy."

Unable to do so, she became increasingly short of cash and unable to pay her bills—rent, car, credit cards. She began alternating payments—the rent one month, credit cards the next, making a car payment after that. That didn't work either, and soon she was getting dunning letters and phone calls. One credit-card company threatened to attach her wages.

"It is just so frustrating to know you owe this much money," she says. "I wish I had the money to pay it off and be O.K.

I can't sleep at night. I have tried to not let it affect me with my children. Kids don't know. They say, 'Mommy, I want this.' 'Can we do that?' My God, if they only knew."

When she fell behind in the rent and her landlord warned that he would evict her, she knew she had to do something. She turned to a Manhattan consumer-bankruptcy lawyer, Charles Juntikka. Garcia was typical of many of his clients—embarrassed by her debts, upset over not being able to pay her bills, not knowing where to turn. "There is this image of middle-class people running up huge debts, then declaring bankruptcy and laughing at everyone," he says. "I've just never seen that. These people hurt."

Juntikka filed a petition for Garcia under Chapter 7, seeking to have her unsecured credit-card debt discharged. Garcia says she intends to give up the car to further reduce her debt load, and Juntikka is optimistic she will get a fresh start. Now, for the first time in months, Garcia says, she can sleep at night.

But if the Bankruptcy Reform Act pending in Congress were the law, Garcia would not be able to rest so easy. "Lucy wouldn't be able to obtain a discharge under this bill," says Juntikka. "Under the new standards Congress has put in the bill, she earns too much money. She could not get a discharge. She would still be stuck with some of the credit-card bills she can't pay now."

The standards referred to by Juntikka concern the means testing that allocates a fixed amount of expenses to debtors in computing their ability to pay their debts. And as Juntikka interprets them, Garcia would not be able to seek relief in Chapter 7. Even if by some chance she could prove her case in court, he says, the process would be lengthy and costly. "People aren't going to be able to deal with these draconian measures," he says. As a result, some people will be permanently indebted to credit-card companies, others will see their wages attached, some may lose their homes. "This is going to cause so much misery," he says.

Warren, the Harvard law professor and longtime student of bankruptcy, marvels at how a piece of legislation that could penalize so many people has come this far. "This is one of those things with low visibility, and therefore it's easy to give in to the interest group," says Warren. "It all flies below the radar screen. That's the best place for the lobbyists. That's where the pickings are the fattest. The only way to explain it is campaign contributions."

—With reporting by Laura Karmatz and Andrew Goldstein and research by Joan Levinstein

Bankruptcy Legislation Still Faces Hurdles

By KATHLEEN DAY
Washington Post Staff Writer

Credit industry lobbyists were all ears earlier this year as lawmakers set the price for passage of legislation to overhaul the nation's bankruptcy system. The bill stood no chance of enactment unless it included a few consumer-protection provisions.

"Lobbyists were told in no uncertain terms that those consumer amendments were their ticket to the dance," said an aide to a key Senate Republican, who spoke on the condition that his name not be used. "We told them if they touched consumer provisions by even a word, the bill was dead. Democrats would kill it."

Lobbyists grudgingly agreed. The legislation, which would make it harder for consumers to wipe out their debts through bankruptcy, now also includes disclosure requirements to help consumers understand how long it will take to pay off debt by making minimum payments.

The concession meant that after three years of trying—and spending more than \$23.4 million in contributions to Democratic and Republican lawmakers and parties—industry groups were closer than ever to getting the bankruptcy bill they wanted enacted.

That was in early February. But now, more than three months later, lobbyists for retail stores such as Saks Fifth Avenue and Home Depot and for credit-card issuers such as MBNA and American Express are biting their nails, wondering if they will ever get to the ball on time.

Although the House passed an industry-supported bankruptcy bill last year and the Senate passed similar legislation Feb. 2, efforts to reconcile differences between the two and send a final package to President Clinton are mired in procedural roadblocks and ideological debates that opponents of the legislation hope—and proponents worry—will kill it.

House and Senate lawmakers and their aides have been working behind the scenes to reconcile differences between the bills. The Senate has sent the House a proposal that House members may counter as early as today.

But even if they get to that point, many parliamentary hurdles remain. And with only 45 to 50 days left in which Congress can do business before it adjourns for the fall campaigns,

both sides believe that lack of time may be the biggest obstacle to final passage.

Consumer groups say the legislation is stacked unfairly against consumers, who they say in most instances file for bankruptcy only when economic hardship forces them to.

But credit-card companies, banks and other retail lenders argue that the overhaul is needed to close loopholes that they say are exploited by people who can afford to repay their debts. Unpaid debt raises the cost of borrowing for other consumers, they say.

Sen. Charles E. Grassley (R-Iowa) and Rep. George W. Gekas (R-Pa.) al-

so note that the bill has wide backing from child-support collection agencies around the country, many state attorneys general and even most Democrats. The legislation passed the House and Senate by wide majorities.

Industry lobbyists worry that waiting until next year may mean dealing with a House in which Democrats have recaptured the majority, a circumstance they say would make legislation much more favorable to consumers and much less to the liking of business.

In general, both the House and Senate bills would make it harder for individuals to wipe out their debt through Chapter 7 bankruptcy, instead requiring more people to file under Chapter 13, which requires a partial, court-supervised repayment over time.

Consumer groups and several Democrats, led by Sen. Paul D. Wellstone of Minnesota and Sen. Paul S. Sarbanes of Maryland, say few debtors abuse the system. They say lenders' liberal credit policies and aggressive sales practices share much of the blame for putting many Americans over their heads in debt. They say the legislation is overly harsh on debtors and should do more to force credit companies to be more responsible by providing more information.

A Senate provision that industry successfully kept out of the House version would require many lenders to disclose how long it would take to pay off a debt making minimum payments. The provision would require many lenders to include a chart on billing

statements that would show the compounding effect of interest. The chart would, for example, show that a \$1,000 credit-card balance paid off at a rate of 2 percent a month and carrying an interest rate of 17 percent would take 88 months, or more than 7 years, to pay off.

Instead of a providing a chart laying out general payment times, companies could opt to give consumers a toll-free number that they could call to get exact, detailed information on how long it would take them to erase bills by making the minimum payments.

The credit industry has now agreed not to fight these provisions in the final bill, but contentious issues remain even among lawmakers who support the legislation. Among them is how expensive a home a bankruptcy filer should be allowed to keep (under current law there are few limits) and how quickly different types of creditors—secured and unsecured—are repaid under bankruptcy reorganizations.

But Wellstone and consumer groups such as Consumers Union, which publishes Consumer Reports magazine, say even the Senate disclosure requirements are not enough to make the legislation consumer-friendly.

In 1999, 1.3 million personal bankruptcy petitions were filed, down 8 percent from the 1.4 million filed in 1998, but still up more than 300 percent from 1980 levels. About 70 percent of those bankruptcies were filed under Chapter 7. According to a study funded by the American Bankruptcy Institute, a nonprofit, nonpartisan educational group, about 3 percent of the people who file under Chapter 7 could repay a portion of their debt under Chapter 13. The credit industry has estimated that the number is closer to 10 percent to 15 percent.

The Clinton administration thinks both bills are too hard on debtors, and has threatened to veto the House version. The Senate version, while closer to the mark, needs work, too, according to the administration.

Lawmakers must also deal with provisions in the Senate version that would increase the \$5.15 hourly minimum wage to \$6.15 over three years and give new tax breaks to small businesses. Because the Constitution forbids the Senate from initiating tax changes, the Senate version poses several parliamentary problems for lawmakers that opponents of the bill have used to stall it.

House Vote For Textile Trade Ends Long Fight

By JOHN BURCESS and MATTHEW VITA
Washington Post Staff Writers

Opponents of economic globalization lost a hard-fought battle in Congress yesterday as the House gave final approval to a measure to facilitate the import of clothing from poor countries in Africa and the Caribbean.

The Clinton administration welcomed the vote, saying it could build momentum toward victory in a vote on China trade later this month.

Yesterday's bill eliminates tariffs for garments made in struggling nations such as Guatemala and Swaziland, making it easier for them to reach American stores. That could kill jobs in the United States' dwindling garment-making industry, but most economists believe the bill is likely to have little overall effect on the booming U.S. economy.

Nonetheless, at a time when millions of Americans question the increasing integration of the world economy, the bill became a symbol of what they feel is wrong with the system. Labor unions, human rights groups, small garment companies, traditional Democrats and some Republicans came together to fight it.

For five years they succeeded, but yesterday they lost in the House, which voted 309 to 110 to pass a conference bill that Senate and House negotiators had agreed on.

The Senate has yet to vote, however, and Sen. Dianne Feinstein (D-Calif.), angry that the final version dropped language intended to facilitate the availability of AIDS drugs in Africa, said yesterday that she might stage a filibuster.

President Clinton hailed the House action, saying in a statement that the bill could "help developing countries lift their people out of poverty."

Administration officials, who had worried that if the bill got stalled it could harm prospects for a bill to normalize trading relations with China, were breathing easier yesterday. "It should reflect positively on the China vote," U.S. Trade Representative Charlene Barshefsky said.

The fight over the Africa-Caribbean bill illustrates the verity that people who are hurt by a trade bill often scream, while those who benefit may never even know they do.

Some of the loudest protests have come from Unite, a union that represents garment workers. "A disgrace" is how Ann Hoffman, the union's legislative director,

described the bill yesterday. "It's a giveaway of apparel jobs," she said. "It's not a trade deal. We give them ... free access to our market, and in return they do nothing."

U.S. jobs in garment and cloth making have dropped from 2.4 million in 1975 to about half that today, according to the union. Hoffman called the bill "a major threat to the jobs of hundreds of thousands of garment workers in the United States."

Bill sponsor Rep. Philip M. Crane (R-Ill.) played down the disruptive effects. "We have a job shortage in this country already," he said. "It's having an impact in ratcheting wages up." Proponents contend that ordinary Americans will benefit from the bill through lower garment prices.

Gene Sperling, Clinton's chief economic adviser, said the bill will bring major noneconomic benefits to the

United States by solidifying relations with the Caribbean and Africa. During a recent trip to Senegal, he said, he met advisers in the government there and they immediately wanted to know about the Africa bill, viewing it as crucial to hopes of development in their country.

The conference bill combines two bills, the African Growth and Opportunity Act and the U.S.-Caribbean Basin Trade Partnership Act. Both were subject to months of negotiations and rewrites as opponents tried to water them down or kill them outright.

As a concession to the opponents, supporters in the end agreed to a complex system in which the most benefits go to clothes made from U.S. fabric, which would preserve textile-making jobs in the United States. In general, these garments can come in any quantity. But with a few exceptions, if local cloth is used, caps are invoked.

U.S. retailers and many clothing companies supported the Caribbean bill strongly, eager to be able to shift production work to nearby countries for import back into the United States. One of the bill's biggest supporters was Fruit of the Loom Ltd. Even without the bill, the Caribbean has become a major garment-making center.

The Africa bill drew much less concern from labor, because with a few exceptions, African countries do not have big garment industries—at present they account for only 1 percent of U.S. textile imports. The bill was supported by many African American members of Congress as a long-overdue gesture to the poor countries of the continent.

In past years "we have allied ourselves with the worst elements and colonial powers in Africa," said Rep.

Charles B. Rangel (D-N.Y.), a prime mover behind the bill. "We should show that that's the past and we

should move forward with new partners, mutual respect, transfer technology and get on with making sure that African countries are part of the global economy."

Lori Wallach of Public Citizen, part of the Ralph Nader consumer organization, faulted the bill for giving the United States power to dictate changes in the economies of countries if they are to receive the benefits.

Tucked into the bill was a measure that requires the United States to rotate items on which it places punitive duties in trade disputes. Congress contends that changing the items periodically will increase pressure on Europe, which is resisting U.S. sanctions over banana trade.

But dropped at the last minute was a measure that would have given power of law to an administration policy to give African countries flexibility in importing and manufacturing AIDS treatment drugs.

February 4, 2000

MEMORANDUM FOR HILLARY RODHAM CLINTON

FROM: ANN O'LEARY

CC: MELANNE VERVEER

SUBJECT: UPDATE ON BANKRUPTCY REFORM

On Wednesday, February 2nd, the Senate passed the Bankruptcy Reform bill in a vote of 83-14-1. While the Administration still has some reservations about the bill, the Senate made a good faith effort to try to strike a balance between debtors and creditors. Apart from the substantive bankruptcy provisions, the Senate choose to approve the Domenici minimum wage and tax amendment that was attached to the bill on the floor.

Improvements in the Senate Bankruptcy Bill

- The Senate bill would cap the homestead exemption – to ensure that the wealthy don’t benefit from a large loophole to avoid their creditors while we ask middle income families to repay the debts that they can.
- We understand that the Senate bill will include a provision sought by Senator Schumer that would protect low-income debtors from motions brought by creditors that too often might be used to threaten or coerce debtors to forego their rights (so-called “motions safe harbor”).
- Similarly, the Senate bill has some (albeit too limited we think) new important credit card disclosures for consumers sought by Senator Torrecelli.
- Finally, the Senate bill has a new “reaffirmation” provision that require courts to look closely for coercion when a debtor says they want to reaffirm a debt (that they are entitled to discharge) but it is clear they do not have the income to repay. (However, here there is an important technical improvement on filing deadlines that Senator Sessions and Reed have agreed to work together to fix during conference.)

Preferred Provisions in the House bill

?????

Minimum Wage and Tax Amendments

Vote: ??

[illegible]

mean is +

- how to report
- distribution not in the
- state will allow for "special circumstances"
- Have "exceptional circumstances"
- "Remedial"

~~2/11~~ - create safe harbor for non-income debtors

very low-income (below median median income
Boston 1.570)

full below median income household get
Chapter 7

Successful

not buy for bankruptcy or reeling debts

below median income

→ safe harbor or safe harbor for high debtors
Credit
monitoring
will be required

tax filing

- file 3 yrs. & tax returns (new)

↓

B/F

- non-dischargeable debt - over 1/Ch 7
taxes, student loans, alimony/child support
| none credit card - non dischargeable
→ take away

2 categories re: at choice:

1) debt - uses credit cards over \$1000 7 non-dischargeable

Minimum wage would be increased from \$5.15 to \$6.15 over three years, instead of over two years as proposed by the Administration. In addition, the amendment included \$76 billion in tax cuts over 10 years – many of which were vetoed by the President in the Republican's 1999 tax package. These tax breaks threaten fiscal discipline

Tax breaks include: pension tax provision – major expansion of pension-related tax preferences for high-income individuals; "above the line" deduction for health insurance premiums

→ m.m.

De-administer > make an agreement of creditors
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bankruptcy reform – now in debt best interests
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 the way

Elm's with letters

↓
 Put. & Demand
 ↓
 Tax
 can

Credit and price → balanced

Ann O'Leary
F 2nd Floor
WW
- First Lady's Office



U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

April 9, 1999

The Honorable Orrin Hatch
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

We understand that the Senate Judiciary Committee is scheduled to mark up S. 625, the Bankruptcy Reform Act of 1999, on April 15, 1999. This letter provides the position of the Administration on consumer bankruptcy reform, and outlines the Justice Department's views on S. 625 as a whole.

At the outset, we want to recognize that S. 625 makes some encouraging improvements over last year's bankruptcy reform Conference Report that provide greater balance to the legislation. We appreciate these important efforts to move this legislation forward in a bipartisan manner. We urge continued movement in that direction in order to win the President's support.

General Administration Perspectives

The President supports responsible bankruptcy reform that is balanced, would reduce abuses of the bankruptcy system, and would require debtors and creditors alike to act responsibly. The President remains hopeful that bipartisan consultation and compromise will result in legislation that he can enthusiastically sign this year.

Last year the Administration expressed its support for the bankruptcy reform legislation that passed the Senate with a virtually unanimous vote. We encouraged passage of the Senate bill "as an important step toward balanced bankruptcy reform," but noted that the Administration would support its enactment

only if the essential reforms incorporated by the Senate managers' amendment [were] preserved and strengthened and the unbalanced and arbitrary elements of the current House bill [were] omitted.

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Although we thought that the Senate bill could be further improved, we believed that the extraordinary bipartisan support for the Senate bill was an endorsement of balance and moderation.

We were disappointed that last year's Conference Report failed to include key provisions of the Senate bill, thus failing the test of balance. As a result, the President's advisors recommended that the President veto the bill if presented to him. Our position has not changed from last year.

While we believe that S. 625 is an improvement over the Conference Report, further changes are needed to achieve balanced bankruptcy reform. During this year's debate, the Administration stands ready to work with the Congress to find an appropriate balance. Among the issues that must be addressed are:

- **Access to Chapter 7:** Any "means test" imposed should deny access to chapter 7 only to those who genuinely have the capacity to repay a portion of their debts successfully under a chapter 13 repayment plan. In addition, any means test should be implemented in a manner that reduces costs to the bankruptcy system. Debtors affected by a means test must be given a meaningful opportunity to have their specific circumstances considered by bankruptcy courts with discretion to determine whether they genuinely have the capacity to repay a portion of their debts. In addition, the time periods and thresholds used in any means test should be set to ensure that only those with a strong likelihood of successfully completing a chapter 13 plan are denied access to chapter 7.
- **Nondischargeable Debts:** It is generally inappropriate to make post-bankruptcy credit card debt a new category of nondischargeable debt. The Bankruptcy Code (hereinafter the Code) makes debts nondischargeable only where there is an overriding public purpose, such as in the cases of educational loans, tax obligations, or debts incurred by fraud, penalties and criminal fines. We remain skeptical that the current protections against fraud and debt run-up prior to bankruptcy are ineffective and that the additional debts made nondischargeable by this bill meet the standard of an overriding public purpose. If categories of nondischargeable debt are to be created, they should be narrowly tailored and limited to situations where the debtor is clearly abusing the system, such as when the debtor: (1) incurred the debt to pay nondischargeable debt with an intent to avoid the debt in bankruptcy; or (2) incurred the debt on the eve of bankruptcy for goods and services that are not reasonably acquired to support the debtor's household.

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- **Coercive Creditor Practices:** Particularly if we are to provide new opportunities for creditors to challenge debtors' use of the bankruptcy system under the 707(b) abuse test, it is imperative that we adequately limit abusive creditor practices such as coercive reaffirmations and violations of the automatic stay. While last year's Senate bill initially took laudable steps in this direction, the Conference Report rolled back existing consumer protections by denying consumers an effective means for remedying the harm from such practices and eliminating the current authorization for penalties for intentional violations of debtor rights. S. 625 does not go so far, leaving existing protections in place, but it fails to address the evidence that existing protections are inadequate to prevent predatory practices that coerce or mislead consumers to make reaffirmation decisions.
- **Consumer Information and Protection:** The challenge posed by the unprecedented level of bankruptcy filings requires us to ask for greater responsibility from both debtors and creditors. Credit card companies must give consumers more and better information so that they can understand and better manage their debts.
- **Homestead Exemptions:** At the same time that we are creating a system that will deny certain moderate-income Americans access to the traditional "fresh start," we should also close the loopholes that allow the wealthy to shield hundreds of thousands of dollars of wealth from their creditors.

Our comments on the particular provisions of S. 625 are as follows:

Section 102. Dismissal or Conversion.

Section 102 amends section 707(b) of the Bankruptcy Code (the "Code"). Under this amendment, a chapter 7 case filed by an individual with primarily consumer debts may be dismissed for abuse upon the motion of any party in interest, with certain limitations. Abuse is presumed when the debtor is able to repay at least 25 percent of non-priority unsecured debts or \$15,000 over 60 months, applying IRS expense guidelines. The debtor may rebut the presumption of abuse by demonstrating special circumstances that justify additional expenses or an adjustment of current monthly income. In deciding whether a case is abusive, the court must also consider whether the case was filed in bad faith or whether the "totality of the circumstances" demonstrates abuse.

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The Department supports strengthening the provisions of section 707 of the Code to ensure that debtors with an ability to repay their debts do not obtain a chapter 7 discharge. Moreover, the Department favors codification of lack of good faith and ability to pay as standards for chapter 7 dismissal. We opposed the rigid means test in last year's Conference Report. While the means test in S. 625 is an improvement over the Conference Report in some ways, it still falls short of a test we can support in some key respects. We look forward to working with you on drafting a means test that we can support.

First, we are concerned that the "thresholds", while more reasonable than those set forth in last year's Conference Report, are still too low, and may still have the effect of denying some debtors chapter 7 relief who in fact have no significant ability to repay their debts. In addition, we believe that these thresholds unnecessarily saddle the bankruptcy system with extra costs, such as reviewing the income and expenses of low income debtors who are not able to repay their debts. We believe that changes should be made to minimize the costs to the bankruptcy system. In addition, we believe that any means test should establish some floor figure for the capacity to repay, below which, regardless of the proportion of debt it constitutes, would render any repayment plan impractical in light of the administrative expenses involved in administering that plan. And, as a more technical matter, this section does not make clear whether the ability-to-repay standards apply only to an individual debtor, or also to joint debtors. Moreover, section 102 makes no upward adjustment for families of more than 4 individuals to compensate for additional expenses.

Second, any rigid use of the Internal Revenue Service (IRS) Standards for allowable expenses is inappropriate. The IRS standards were meant to provide guidelines for determining appropriate expenses. Last year during its consideration of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206, Congress criticized the inflexible application of those guidelines and directed the IRS to also consider the taxpayer's facts and circumstances. The Joint Committee on Taxation explained the attitude of Congress regarding the guidelines in the following terms:

The IRS is . . . required to consider the facts and circumstances of a particular taxpayer's case in determining whether the national and local schedules are adequate for that particular taxpayer. If the facts indicate that use of scheduled allowances would be inadequate under the circumstances, the taxpayer is not limited by the national or local allowances.

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See General Explanation of Tax Legislation Enacted in 1998 at 107 (1998) (emphasis added). Bankruptcy courts should be given as much discretion in applying the IRS guidelines. Debtors should have the ability to rebut any presumption based on rigid measures by demonstrating to the court's satisfaction circumstances that justify additional reasonable expenses or adjustments of income.

Third, and as a related matter, the hurdles for rebutting the presumption of abuse raise some concern, although we prefer the formulation set forth in S. 625 rather than that set forth in last year's Conference Report. Specifically, the debtor can rebut by demonstrating "special circumstances" that justify additional expenses or adjustments of income. We think this is more appropriate than the formulation set forth in the Conference Report, although more explicit language should be included so as not to preclude the debtor from proving the existence of circumstances that justify additional reasonable expenses or adjustments of income. We object to the "necessary" limitation in connection with the analysis of expenses. We believe the bankruptcy courts will use whatever discretion they have under the abuse standard narrowly. Indeed, we believe that the courts should have expanded discretion in this regard, which could be tempered by a requirement that the court provide a written statement as to its reasons for finding additional expenses sufficient to overcome the presumption of abuse.

Fourth, the procedures set forth in Section 102 would impose a substantial burden on the courts and the trustees, threatening to significantly clog the formal bankruptcy processes and to compromise the intended purpose of these amendments. The proposal requires the United States Trustee to file a statement in every chapter 7 case involving an individual consumer debtor as to whether the case is presumed abusive. This will involve a substantial portion of the cases filed. The statement must be filed 10 days before the section 341 meeting. The clerk, in turn, has only five days to notice the statement to all creditors. This will be the second notice that is sent to all creditors in the early days of each chapter 7 case. Thus, in addition to all the duties that are currently performed (such as ensuring that trustees are appointed and notified, section 3412 meetings are set and noticed, papers are filed, emergent issues are addressed, and cases evaluated for possible abuse and section 707(b) issues), the limited time and resources of the United States Trustee and court clerk will be diverted to evaluating and noticing these statements.

Section 102 requires the United States Trustee to file the presumed abuse statement; by contrast, the parallel provision in H.R. 833 requires the chapter 7 trustee to file the statement. Regardless of who performs this function, however, it is

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impractical to require the filing of any such statement before the meeting of creditors, especially when section 316 of S. 625 gives debtors up to 45 days to complete their schedules, and liberal amendments to schedules are permitted. More importantly, the necessity of such a statement is doubtful insofar as section 102 requires the debtor to file a statement containing the necessary ability to repay calculations. The deadline for filing the statement is too short to conduct any meaningful analysis or to obtain further information about claimed expenses.

Fifth, we do not think it appropriate for Section 102 to impose a higher duty on debtor's counsel than that set forth in Rule 9011, and are concerned that the formulation set forth in Section 102 could be so interpreted. Moreover, we are concerned that the reformulation of Rule 9011, provided for in Section 319, is similarly confusing.

Sixth, we do not believe it is appropriate to remove the risk of sanctions from all creditors who bring unjustified Rule 707(b) motions just because those creditors' claims may be less than \$1000. The sanctions provision is designed to protect debtors and to deter creditors from engaging in abusive or coercive tactics. Any exception to encourage small business creditors to bring appropriate section 707(b) motions should be drafted far more narrowly. It is bad policy to permit any creditor, even those with small claims, to file motions that are coercive or not substantially justified. Otherwise, the exception may swallow the rule, and will serve to protect large creditors with small claims, who clearly do not need this protection.

Seventh, we generally support the move to use both State and national median income figures.

Eighth, section 707(b) should be expanded to cover tax debts as well as consumer debts. The expansion is needed because taxes are not considered to be consumer debts, and section 707(b) should be available to prevent debtors from discharging tax claims in a chapter 7 proceeding when they are capable of repaying those and other obligations in chapter 13.

Finally, there are several drafting errors, which we would be pleased to address separately. We would note one major error, however. In section 102(b)(2)(B), the amendment to section 704(b)(2)(B) appears to have a large passage of text omitted at the end.

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Section 103. Notice of Alternatives.

Section 103 would, in part, amend section 342 of the Code to ensure that consumer debtors receive information about debt counseling services and their options before filing bankruptcy. The form of the notice would be prescribed by the United States Trustee for the district and would contain a brief description of the bankruptcy chapters, the benefits and costs of each chapter and services available from a credit counseling service approved by the United States Trustee for that district. We support the concept of consumer education that underlies section 103.

Section 104. Debtor Financial Management Test Program.

Section 104 would require the Executive Office for United States Trustees, in consultation with experts, to develop a financial management training curriculum for debtor education in three pilot districts for a one year period. The materials would also be made available to individual debtors on request. The courts in the pilot districts would be authorized to make attendance at the debtor education program a condition of discharge. The Director of the Executive Office would also be required to evaluate the effectiveness of the pilots and existing debtor education programs and to submit a report of his findings to Congress.

Provided that adequate resources are appropriated for the test program, the Department supports this as the best way to refine effective debtor education programs before they are extended nationwide. However, this section needs to be reconciled with section 105(b) and (c) insofar as they create confusion as to whether debtor education is to be a test or a permanent program. Section 105(b) and (c) condition the debtor's discharge upon completion of "an instructional course concerning personal financial management described in section 111." This language suggests a permanent program.

Section 105, and Sections 221 to 224. Credit Counseling and Debt Relief Agencies.

Sections 105 and 221 to 224 deal with credit counseling. Section 105 bars any debtor from filing a petition unless they have sought the assistance of credit counseling during the 90-day

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period prior to the filing of the petition. This provision does not apply in certain circumstances, such as filings due to exigent circumstances. Section 105 also requires debtors to attend educational courses prior to discharge in chapter 7 and 13 cases. Section 105 requires the clerk of the court to maintain a list of non-profit credit counseling services and educational courses that have been approved by the U.S. Trustee.

We support the concept of credit counseling but question whether the utility of making it mandatory particularly in chapter 13 where individuals will already be seeking to repay their creditors through a debt repayment plan. We also have concern about the requirement for United States Trustees to approve credit counseling agencies because it is a large, unstructured and unregulated segment of the financial services industry. The list of approved agencies will serve as a Federal guide for would-be debtors, and we expect it will attract applicants of varying degrees of character and quality. It is important that the United States Trustees have sufficient tools and discretion to address the problems that will undoubtedly emerge. With one exception discussed below, the provision appears adequate, but sufficient resources must also be made available. We might also suggest, as an alternative, that a pilot program be created first in several districts to test the usefulness of credit counseling and its impact on filings.

One issue appears to have been overlooked and should be addressed. There is no automatic dismissal to enforce this provision if a debtor fails to file a certificate from a counselor pre- or post-petition. Assuming the petition gets filed without a certificate, a party would then have to move to dismiss the case under 707(a), 1112(b), 1208(c), or 1307(c) based on the debtor's ineligibility.

Section 105 (b)-(c) provides that a chapter 7 and a chapter 13 discharge are conditioned upon the debtor's completion of a post-filing instructional course. As noted above, section 104 appears to contain provisions for a pilot program, but this provision seems to assume a permanent program. There is a need to clarify this provision. A pilot program is preferable.

Section 221 defines covered debt relief agencies. Section 222 would require such agencies to provide the person they are assisting in filing bankruptcy with written notice of the requirements that all bankruptcy schedules must be accurate, that the information is subject to audit, and that the failure to provide accurate information may result in dismissal of the bankruptcy case, sanctions or criminal prosecution. Debt relief agencies would be required to provide a separate notice advising the assisted person that the debt relief agency is required,

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inter alia, to enter a written contract. Finally, debt relief agencies would be required to inform assisted individuals on matters such as "how to determine what property is exempt" and how to "value exempt property."

The Department opposes section 222 as currently drafted, because it would undercut the consumer protections currently contained in section 110 of the Code and state laws. These provisions impose penalties on persons who negligently or fraudulently prepare bankruptcy petitions. Because debt relief agencies would be defined to include petition-preparers and other non-attorneys, the advice required to be given by a counseling agency could constitute the unauthorized practice of law. To avoid this problem, section 222 should be amended to exclude non-attorneys from the provisions of new section 526(c).

Section 223 would provide the assisted person certain substantive rights when using a debt relief agency, including the right to a written contract that fully discloses all services and all charges. We do not oppose this concept, but believe that the standard of liability in the provisions should be changed. Proposed Section 527 (b) (2) provides that a debt relief agency shall not "make any statement . . . which is untrue and misleading or which upon the exercise of reasonable care, should be known by the debt relief agency to be untrue or misleading." (emphasis added). The underlined disjunctive "or" would impose strict liability upon a debt relief agency by imposing liability if the statement is untrue and misleading, even if the agency had no reason to know of the untruthful or misleading nature of the statement. The Department suggests replacing the underlined "or" with "and" to establish a more appropriate standard of liability.

Finally, section 224 would provide penalties and other remedies on debt relief agencies for failing to comply with the requirements of sections 222 and 223, or for providing bankruptcy assistance in a case which is dismissed or converted for a failure to file bankruptcy papers. Section 224 should be clarified to ensure that a debtor may bring an action to remedy any violation.

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Section 201. Promotion of Alternative Dispute Resolution.

Section 201 would create an incentive for the parties to use alternative dispute resolution prior to the filing of a petition. We wholeheartedly support efforts to encourage the use of alternative dispute resolution in this context, but believe Section 201 is too restrictive. Under this section, alternative dispute resolution would be encouraged by imposing a penalty in cases where a creditor unreasonably refused to negotiate an alternative repayment schedule proposed by an approved credit counseling agency. The penalty applies if the debtor's offer was made at least 60 days prior to the filing of the petition; and the offer provided a specified percentage payment (60% over a specified time). A more effective approach would be to encourage parties to use any appropriate neutral, and give them leeway to determine when it is appropriate to settle and for what amount. Moreover, it should be clarified that this provision does not apply to the government as a creditor given the peculiar nature of many debts owed to the government. We would be happy to work with the Committee to draft a more effective rule.

Section 202. Effect of Discharge.

Section 202 states that the willful failure of a creditor to credit payments received under a confirmed plan shall constitute a violation of an injunction under subsection 524(a)(2) of the Code. We support this provision but suggest two modifications. First, the court should be given discretionary, rather than mandatory, authority to grant sanctions. Second, we suggest the provision be amended to require the debtor first to exhaust efforts to obtain administrative relief where applicable.

Section 203. Automatic Stay.

Section 203 provides that a creditor violates the automatic stay provision when it engages in "any communication . . . threatening a debtor (for the purpose of coercing an agreement for the reaffirmation of debt), at any time after the commencement and before the granting of a discharge, . . . of an intention to" file a motion to dismiss or convert the case or repossess collateral from the debtor to which the stay applies. We generally support this provision as a helpful, although not itself adequate, way to limit abusive reaffirmations. The effect of this provision is limited since the debtor will have to prove that the creditor's intent was to coerce an agreement; establishing such evidence will be difficult.

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Section 204. Discouraging Abuse of Reaffirmation Practices.

Current reaffirmation practices reveal a problem of great significance: the large number of reaffirmations undertaken by debtors that are not in their best financial interest. Many are due to prompting or threats by creditors designed to coerce debtors into reaffirming debts, particularly unsecured debts. Others may be the result of a lack of understanding of the agreement coupled with eagerness to retain some item of collateral or retain some access to credit that they believe they may otherwise lose.

Currently, section 524(c) of the Code imposes certain safeguards designed to ensure that debtors make informed and uncoerced decisions about whether to reaffirm a debt but the evidence suggests that these safeguards are ineffective and insufficient. The National Bankruptcy Review Commission recommended even stricter rules regarding reaffirmation of secured debt, and the complete elimination of reaffirmations of unsecured debt. While we would prefer not to bar reaffirmations on unsecured debt entirely, leaving it possible for debtors to repay debts that they are able and willing to repay, we can only be comfortable leaving that option in place if effective safeguards are in place.

Section 204 attempts to address the problem of coerced and unwise agreements by requiring that creditors provide a disclosure that the debtor is entitled to a hearing on the reaffirmation agreement. The debtor can also waive his right to a hearing if represented by counsel.

We believe that a far more effective approach would:

- (1) require disclosure of the component amounts of any debt to be reaffirmed, and, in the case of secured debt, of the collateral;
- (2) require disclosure of the effective terms of any credit being provided as a condition of the reaffirmed debt in a form similar to that required under the Truth-in-Lending Act so that the debtor can effectively compare the terms of credit with other options;
- (3) require court review for reaffirmations of relatively small amounts where the creditor claims a purchase money security interest; and
- (4) prohibit the addition of costs and attorneys fees on at least these smaller claims.

We would be happy to work with the Committee to develop more effective rules to discourage abusive reaffirmation practices.

Section 204 also amends section 158 of the Code to require the Attorney General to designate United States Attorneys and Federal Bureau of Investigation agents to address abusive reaffirmations of debt in each judicial district. While we support the goal of appropriate federal enforcement, we oppose

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this provision on the ground that it is an unnecessary intrusion into the internal management of the various United States Attorneys Offices. Nevertheless, the United States Attorneys Offices recognize the importance of prosecuting abusive reaffirmation practices within their jurisdiction, such as in the Sears case, and do not feel that formal designation of a point of contact on reaffirmation issues will materially aide their ability to pursue such cases.

Sections 211 to 219. Priority Child Support.

Section 211 establishes domestic support obligations as the first priority. We generally support this recognition of the critical societal importance of ensuring that domestic support obligations are not unduly reduced as a result of a debtor's bankruptcy. Without payments from domestic support obligations, the recipients of those payments may become destitute; it is therefore appropriate to give them a high priority. However, if an appropriate mechanism for funding the administrative costs of bankruptcy is not provided, too many debtors will go without counsel thereby imposing substantial burdens on the entire bankruptcy system. We would like to work with the Committee to ensure that there are no unintended consequences of this priority for domestic support obligations.

Sections 212 to 219 establish other special rules in the domestic support obligation context. Sections 212 and 213 establish special rules regarding confirmation and discharge, and exceptions to the automatic stay, in cases involving domestic support obligations. Section 214 makes certain domestic support obligations non-dischargeable. We support these provisions for the reasons stated above.

Section 302. Discouraging Bad Faith Repeat Filings.

In cases of refiling within a year, section 302 would provide a 30-day limit on the application of the automatic stay of section 362 of the Code. This section would not apply if, prior to termination and upon request of a party-in-interest, the court provides notice and a hearing to affected parties regarding the potential extension of the stay. Serial filings are a serious problem in many jurisdictions and, accordingly, we endorse the adoption of firm measures to address this issue. Repeat filings -- whether to obtain multiple discharges or to hold creditors at bay temporarily -- should not be encouraged or abided. This provision would provide a welcome limitation to abuse of the automatic stay provision of the Code by serial filers who have no hope or intention of ever being granted a discharge in bankruptcy.

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Section 306. Giving Secured Creditors Fair Treatment In Chapter 13.

Section 306 would amend section 1325(a)(5)(B)(i) of the Bankruptcy Code to protect the lien of a secured creditor from release by a chapter 13 plan if the debtor fails to complete the plan. This provision would resolve an issue on which the bankruptcy courts are split. The issue arises when the debtor confirms a chapter 13 plan that reduces a creditor's lien to the current value of the collateral (so-called "lien stripping") and then, after completing the payments due on the secured portion of the claim, but before the plan is completed, the debtor seeks to discharge the lien. Some courts hold that the collateral does not vest in the debtor until the entire plan is completed. See, e.g., In re Pruitt, 203 B.R. 134 (Bankr. N.D. Ind. 1996); In re Schieirl, 186 B.R. 498 (Bankr. D. Minn. 1995). Other courts have held that, upon payment of the secured portion of the creditor's claim, the collateral is released. See, e.g., In re Lee, 156 B.R. 628 (Bankr. D. Minn.), aff'd, 162 B.R. 217 (D. Minn. 1993); In re Nicewonger, 192 B.R. 886 (Bankr. N.D. Ohio 1996).

We support the limitations on lien discharge contained in section 306. A key advantage that chapter 13 offers debtors over chapter 7 is that a larger universe of property is subject to lien "strip down." Furthermore, in a chapter 13 plan, the debtor can redeem collateral with payment over time from future income. These advantages are often the debtor's chief reason for undertaking a chapter 13 plan. But because debtors may allocate their plan payments preferentially to pay secured indebtedness sooner than unsecured debt, the result can be a disincentive for debtors to finish their plans after paying enough to redeem the collateral. Debtors should not be permitted to obtain the benefits of chapter 13 without bearing its burdens.

Section 306 also amends section 506 of the Code in individual cases by barring the stripping of liens for an automobile acquired by the debtor within 5 years of filing the bankruptcy petition, and 6 months for other property. Currently, the debtor's power to strip liens to the value of the collateral in plans under chapters 11, 12 and 13 is not limited by the time lapsed since purchase.

We oppose the longer look-back for automobiles, and believe a more balanced approach to be to return to the 180 day look-back that was considered in the last year's legislative proposals.

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Sections 307 and 308. Exemptions; Residency Requirement for Homestead Exemption.

Section 307 would amend section 522(b)(2)(A) of the Code to permit the use of state exemptions only if the debtor has been domiciled in the respective state for at least two years before filing. With specific respect to the homestead exemption, Section 308 would provide that the homestead exemption shall be reduced to the extent that the value of the homestead property was attributable to any portion of property the debtor disposed of within the two year limit with the intent to hinder, delay or defraud creditors.

We urge that the homestead exemption be limited uniformly to \$100,000 for the reasons set forth in the General Administration Perspectives section of this letter.

Section 309. Protecting Creditors in Chapter 13 cases.

Section 309 has three provisions. Subsection (a) restores a lien strip down achieved under chapter 13 which is converted. Subsection (b) clarifies the bankruptcy status of leased property where the lease is not timely assumed. Subsection (c) requires the debtor in chapter 13 to begin lease payment or adequate protection payments to a lessor or secured creditor, respectively, within 30 days after filing the petition. We support these provisions.

Section 310. Limitations on Luxury Goods.

Section 310 would amend section 523(a)(2)(C) of the Code to change the non-dischargeability rules for certain so-called luxury goods. First, it defines "luxury goods or services" so as to exclude those "reasonably necessary for the support or maintenance of the debtor or a dependent of the debtor." We prefer the formulation "reasonably acquired." Moreover, by including the word "necessary" the burden shifts to the debtor to demonstrate that he or she "needed" the items expended. Second, it would establish a cap on dischargeable luxury goods or services of \$250 incurred with 90 days, or cash advances of \$750 incurred within 70 days, of filing the petition. We oppose the limitation regarding cash advances, although we believe the formulations are preferable to those set forth in H.R. 833. Nonetheless, this would be a substantial change from the current law, which sets forth limits of \$1075 during the preceding 60 day period. Moreover, it is important to bear in mind that cash advances are not always obtained for frivolous expenses; debtors sometimes use cash advances to buy absolute necessities such as groceries.

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Section 314. Nondischargeable Debts.

Section 314 amends section 523(a) of the Code in two ways. First, it would make non-dischargeable any debt that was incurred to pay an otherwise non-dischargeable debt with the intent to discharge the newly acquired debt. We support this change.

Second, section 314 would also impose a presumption of non-dischargeability for most debts incurred to pay non-dischargeable debts, if incurred within 70 days of the petition. Proponents of this provision argue that one can presume that the debtor had the intent to avoid the debt in bankruptcy if they paid the nondischargeable debt with a dischargeable debt within 70 days of bankruptcy. Unfortunately, that is not always a fair assumption. In the final months before filing a bankruptcy petition, a debtor may be struggling to retain a house or a car or feed a family. Accordingly, he or she may put debts on their credit card in a last attempt to meet their obligations. A review of the debtor's intent (for example, by looking at whether the debtor had yet consulted with bankruptcy counsel or whether the debtor had previously filed for bankruptcy and therefore was familiar with the rules) could uncover whether the payment in fact was abusive or not. We favor this provision over the parallel provision in H.R. 833, because this S. 625 provision imposes only a "presumption" regarding intent. However, we believe that the nature of the presumption and the respective burdens flowing from that presumption should be clarified.

Section 315. Fair Notice.

Section 603 would amend the notice provisions of section 342 of the Bankruptcy Code in an individual bankruptcy case. It allows creditors to file their preferred address with the court. Beginning 30 days following the filing of that notice, creditor notices not sent to that address are deemed ineffective until the notice has been brought to the attention of the creditor.

We strongly support the intent of this section to ensure that debtors know how to give effective notice and that the creditors, in fact, receive such notice. However, we generally prefer the parallel notice provision in H.R. 833, section 603, which requires that the debtor include the account number in notices and serve notices at the address the debtor has designated in correspondence. Moreover, we are concerned about the potentially draconian effect of failure to provide adequate notice, and suggest that a redemptive provision be included so that errors can be corrected in appropriate cases.

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Section 316. Dismissal for Failure to Timely File Schedules or Required Information.

Section 316 provides that in voluntary cases under chapters 7 or 13, a case shall automatically be dismissed if the debtor fails to file all required information within 45 after filing the petition. The Department does not oppose this provision, so long as dismissal is without prejudice, and we suggest an appropriate clarification.

Section 317. Adequate Time to Prepare for Hearing on Confirmation of the Plan.

Section 317 requires the hearing on confirmation of a chapter 13 plan to be held not later than 45 days after the section 341 meeting. In addition, it would give a chapter 13 debtor up to 90 days after the order for relief to file a chapter 13 plan. Under current law, a debtor must file a plan within 15 days from entry of the order of relief. Fed. R. Bankr. P. 3015(b). The Department opposes this enlargement of time as contrary to the principles of expeditious case administration. Due to other provisions in this section requiring the debtor to file certain information and documents with the petition, both the chapter 13 debtor and debtor's counsel should be well prepared to propose a plan within the current 15-day window. The short deadline is also consistent with the proposed deadline for plan confirmation; otherwise, the hearing date could occur before the plan is even due to be filed.

Section 318. Duration of Chapter 13 Plan.

Section 318 amends 11 U.S.C. 1322(d) to provide that chapter 13 plans may not extend beyond 3 years except when the court for cause approves a longer period, not to exceed 5 years. This parallels existing law. However, one exception is made in this proposal for cases which are converted from chapter 7 to chapter 13. In that situation, the plan must provide for payment over a period of 5 years. If this proposal is meant to punish those who file chapter 7 only to convert later, we do not think it will be effective. Chapter 13 debtors can dismiss their cases at any time. More importantly, to state that a plan cannot be shorter than 5 years, may raise Constitutional concerns about involuntary servitude. Finally, in those cases where debtors can easily repay creditors in a much shorter period of time, this provision would actually hurt creditors and assist the debtor by extending the payments out.

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Section 320. Prompt Relief from Stay in Individual Cases.

Section 320 provides that, in any individual case under chapters 7, 11 or 13, the automatic stay shall terminate 60 days after requested by a party unless the court makes a final decision, the parties agree to an extension, or the court finds good cause supporting an extension. We support this provision.

Section 403. Meetings of Creditors and Equity Security Holders.

Section 403 would amend section 341 of the Code to allow a court to direct the United States Trustee to dispense with the meeting of creditors in a case with a so-called "pre-packaged plan", i.e., a reorganization plan worked out with creditors in advance of the filing of a Chapter 11 petition. We oppose this provision, which would significantly hinder the ability of creditors and the United States Trustee to examine a debtor's affairs under oath. Dispensing with the meeting could also increase the possibility of fraud and collusion by a debtor and its major creditors. We suggest this provision be deleted.

Section 405. Executory Contracts and Unexpired Leases.

This section requires a debtor to assume an unexpired lease of non-residential real property within 120 days after filing the petition or the lease is deemed rejected. We support this provision, and indeed prefer this provision to the somewhat longer period provided in H.R. 833.

Section 406. Creditor and Equity Security Holders Committees.

Section 406 would amend section 1102 of the Code to allow a court to order changes in the membership of creditor and equity security holder committees. We strongly oppose this provision. Under section 1102 of the Code, United States Trustees are responsible for creating committees and appointing their members, while courts are called upon to resolve controversies arising from the committees. Section 406 would upset this balance and improperly involve the court in the administration of cases. This could create an appearance of favoritism if a court were called upon to resolve a controversy involving a committee it had constituted. The proposal could also result in increased cost and delay because early litigation over committee membership would inevitably decrease the ability of committees to participate at the early, critical stages of cases.

Nevertheless, the Department recognizes the desirability of revising section 1102 to ensure that effective and representative committees are appointed. Accordingly, we would suggest that

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this section be amended to require that any request to create or alter the membership of a committee be first directed to the United States Trustee and to permit the court, upon a request of a party in interest after an adverse decision by the United States Trustee, to make the requisite findings and order the United States Trustee to alter a committee. Such an amendment should also reaffirm the United States Trustee's authority to alter a committee. We would be happy to work with the Committee to draft language to accomplish this objective.

Section 409. Amendment to Section 330(a).

Section 409 would provide that in determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission based on the results achieved. We oppose this provision, which would create a singular incentive that could lead to abuses, or the perception of abuses, on the part of the trustee. We prefer the current multifactor analysis set forth in section 330(a)(3) of the Code.

Section 411. Preferences.

Section 411 would amend section 547(c) of the Code, which deals with preferential transfers of property to creditors after the filing of a bankruptcy petition. Section 411 would eliminate the ability of a trustee to avoid such a transfer in a case filed by a debtor whose debts are not primarily consumer debts, where all the property that constitutes or is affected by the transfer is worth less than \$5,000.

We oppose this provision. Although this provision is apparently designed to protect the interests of smaller creditors, this section, without appropriate supervision, could lead to abuse and manipulation by debtors wishing to pay preferred creditors. For example, nothing in the provision would prohibit a debtor from breaking a larger payment into several smaller ones that each total less than \$5,000. If such preferential payments are not avoidable, the result could be a substantial diminution of the property available to pay priority claims.

Section 415. Creditor Representation at First Meeting of Creditors.

Section 415 would amend section 341 of the Code to allow non-attorney consumer creditor representatives to attend and participate in chapter 7 and chapter 13 creditors' meetings notwithstanding federal, state or local non-bankruptcy law to the contrary. The Department supports this provision because it

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promotes the participation of creditors in the bankruptcy process. We strongly encourage further amendment to delete the phrase "holding a consumer debt" from the section to ensure the ability of all creditors, including non-lawyer representatives of governmental creditors, to participate in creditor meetings.

Section 416. Elimination of Certain Fees Payable in Chapter 11 Bankruptcy Cases.

Section 416 would amend section 1930(a)(6) of title 28, United States Code, to exempt all debtors whose quarterly disbursements are less than \$300,000 from paying post-confirmation quarterly fees. The Department opposes this provision because it would eliminate one of the most effective tools to encourage the prompt administration and closing of chapter 11 cases. This section would also result in a revenue loss to the United States Trustee Program of at least \$9 million annually and would require a new source of funding to replace that loss, since the Program is a fully fee funded agency.

Sections 421 and 423. Flexible Rules for Disclosure Statement and Plan; Standard Form Disclosure Statements and Plans.

Section 421 would add a new section 1125(f) to the Code to allow the court to relax the plan confirmation procedures in small business bankruptcies. Specifically, for a small business case, the court would be empowered to: (i) waive the disclosure statement; (ii) use a form disclosure statement; (iii) allow plan solicitation based on a "conditionally approved" disclosure statement; or (iv) combine the confirmation and disclosure statement hearing. Section 423 would require the Judicial Conference to adopt "standard form" disclosure statements and plans of reorganization that balance the need for "reasonably complete information" with "economy and simplicity."

These provisions would remove procedural barriers to early confirmation and, to the extent they encourage quicker confirmations, are advantageous to debtors and creditors alike. Care will be needed lest the execution of these provisions lead to confirmations without adequate disclosure to creditors and other affected parties. We believe, however, that this risk is manageable. Accordingly, we support this provision.

Section 422. Definition.

Section 422(a) defines the terms "small business debtor" and "small business case." The definition of small business case is apparently missing some words, but it appears that the definition excepts cases where a creditors' committee is formed and the

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court determines that it is "sufficiently active and representative to provide effective oversight of the debtor." This apparent exception defeats the purpose of the small business provisions to minimize the time a case remains in bankruptcy because it could lead to litigation over the exception. The exception should be eliminated so that there is certainty at the commencement of the case whether it involves a small business or debtor.

Section 424. Uniform National Reporting Requirements.

Section 424 would add a new section 308 to the Code requiring a small business debtor to file periodic reports explaining: (i) its profitability; (ii) projected income and expenses; (iii) how prior projections compare with actuality; (iv) compliance with bankruptcy requirements; (v) whether tax returns are timely filed; (vi) what taxes and other administrative claims are in default and when remedied; and (vii) "other matters" needed in the creditors' and the public's interest.

We support these disclosure requirements and the need for consistent financial reporting standards. By helping to identify faltering cases, financial reports prevent undue delay in the administration of chapter 11 cases. We further urge extending this section to all chapter 11 debtors, not just small business debtors.

Section 425. Uniform Reporting Rules and Forms.

Section 425 would require the Judicial Conference of the United States to propose for adoption amended Federal Rules of Bankruptcy Procedure and Official Bankruptcy Forms to be used by small business debtors to comply with the provisions added by Section 424 of the bill. We support this provision, with one exception: it should be amended to indicate that the Attorney General will promulgate the report forms. This is consistent with section 603 under which the Attorney General is to propose these forms and to collect data based on the information reported. It is essential that these two functions be merged under the same authority.

Section 428. Plan confirmation deadline.

Section 428 requires that small business chapter 11 cases be confirmed within 150 days of filing. This time period may be enlarged only if the debtor demonstrates by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable time.

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The Department encourages the prompt disposition of cases, but the 150-days cutoff may be too short. Currently only 4% of chapter 11 confirmations occur within 150 days of filing. Although substantial improvements in processing times have occurred during the last decade, the majority of confirmations still occur more than one year after filing. Additionally, over 60% of dismissals and conversions to chapter 7 occur more than 150 days after filing. Although section 428 would allow enlargement of this time period, our statistics show that only about 30% of chapter 11 cases result in confirmation. Furthermore, based solely on when a case is filed, there is no age at which a chapter 11 case has a 50% or better chance of being confirmed. Thus, while we support the purpose of this provision, we do not think it is necessary.

Section 430. Duties of the United States Trustee.

Section 430 would amend 28 U.S.C. § 586 to expand the United States Trustee's oversight of small business debtors. It would oblige the United States Trustee to interview the debtor before the first meeting of creditors, visit the debtor's premises, monitor the debtor's actions and, where grounds are found to do so, move to convert the case to a chapter 7 or to dismiss the case altogether.

We support this provision, which would clarify and codify the United States Trustee's obligation to move hopeless cases out of chapter 11. This section reflects the current practice of the United States Trustees, except for the duty to visit the debtor's premises. We estimate that site visits would cost an additional \$10 million over 5 years.

Section 431. Scheduling Conferences.

Section 431 would amend section 105(d) of the Code to require the courts to hold status conferences "as are necessary." This provision would apply to all chapter 11 cases. To the extent it empowers the court to override requirements of the Code and Bankruptcy Rules, or to intrude into areas currently entrusted to the United States Trustee, it goes too far. While bankruptcy procedures should be somewhat flexible, we believe that it is important that bankruptcy judges not be permitted to vary, essentially at will, from statutory and rule requirements, potentially depriving creditors and other parties in interest of key procedural protections. We believe that the standard incorporated in section 431 does not adequately preserve these procedural protections, and we therefore oppose the provision.

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Section 432. Serial Filer Provisions.

Section 432 would amend section 362 of the Bankruptcy Code to disable the automatic stay for a small business filing where: (i) the debtor is already in bankruptcy; (ii) had a case dismissed or a plan confirmed within two years prior to filing; or (iii) acquired the assets of another debtor in a proceeding covered by (i) or (ii), unless the debtor shows that its filing resulted from causes unforeseeable during the prior case and that a non-liquidating plan may be confirmed within a reasonable time.

Serial filings are a serious problem in many jurisdictions and we endorse the adoption of firm measures to address this issue. Repeat filings -- whether to obtain multiple discharges or to hold creditors at bay temporarily -- should not be permitted. Accordingly, we support section 432 of the bill. However, we believe that applying this restriction only to small business debtors is too limited and that this provision instead should apply to all debtors in chapter 11.

Section 433. Expanded Grounds For Dismissal or Conversion and Appointment of Trustee.

Section 433 would amend section 1112 of the Code to require the conversion to chapter 7 or dismissal of any chapter 11 case where "cause" is shown. This requirement would not apply if the debtor could show that a plan may be confirmed within a reasonable time and, where the "cause" is a default, that the default is justified and will be cured promptly. "Cause" would be defined to include a variety of situations, including gross mismanagement; misuse of cash collateral; a violation of a court order; default of a filing or reporting requirement; the nonpayment of taxes or nonfiling of a return; and not filing timely a disclosure statement or plan or confirming a plan.

We support this provision. It is one of several in the bill designed to move cases that cannot be confirmed out of chapter 11. Defining "cause" using more objective standards would foster uniformity and enhance efficiency. Shifting the burden to the debtor to justify defaults and prove satisfactory progress when cause is shown appropriately conditions the debtor's enjoyment of the benefits of bankruptcy on responsible actions.

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Section 435. Payment of Interest.

Section 435 would amend section 362(d)(3) of the Bankruptcy Code to limit the automatic stay in a Single Asset Real Estate (SARE) case, where the debtor fails to file a plan or commence interest payments within 90 days of filing, to: (i) allow the payment to commence 30 days after the court determines that the debtor is a SARE; (ii) allow the debtor to make the interests payments from post-petition rents of the SARE; and (iii) specify the non-default contract rate as the interest rate.

We oppose this change. Under current section 362(d)(3) of the Code, creditors of a SARE debtor may have the automatic stay lifted if the debtor has not filed a "feasible" reorganization plan within 90 days of filing or has not commenced monthly payments to secured creditors. Giving the debtor 30 days to comply after the court rules that the debtor is subject to section 362(d)(3) is unwise. The exception to the automatic stay in section 362(d)(3) takes its force from the 90 days time limit. That force is substantially diminished by relaxing that limit for debtors who claim, or who can find a pretext for claiming, that it does not apply. It is also unnecessary; the court currently can extend the 90 days for "cause."

Giving the debtor the "sole discretion" to override section 363(c)(2) and make interest payments out of post-petition rents is also ill-advised. First, the amendment does not require that the creditor receiving the rents be the same as the creditor whose rights are voided. Second, even if the creditor receiving the rents is being paid its own collateral, the amendment serves to limit that creditor's rights. Currently, this section works largely as a predicate to allow the secured creditor and the debtor to negotiate a consensual payment schedule. Giving the debtor the discretion to override the secured creditor's interests stands the purpose of the section on its head.

Finally, allowing the debtor to pay at the contract rate is inconsistent with paying a "stripped down" value in the case of an undersecured creditor. If the payment's principal is a function of market value, the interest rate should be calculated the same way. We oppose this change as well.

Section 601. Audit Procedures.

Section 601 would amend 28 U.S.C. § 586 to require the Attorney General to establish procedures for auditing of a

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debtor's petition, schedules, statement of financial affairs and other similar information in all consumer chapter 7 and 13 cases. At least one out of every 250 of the consumer cases in each judicial district would be randomly chosen for audit, in addition to those cases where the debtor's income and expenses exceed the mean variance in the judicial district.

The Department supports the concept of debtor audits. The bankruptcy system is dependent upon the full and voluntary disclosure by debtors of accurate information regarding their assets, liabilities and financial affairs. A systematic program of random audits would serve to deter those who might otherwise be tempted to conceal assets and information from their creditors. We also believe assigning this responsibility to the Department makes sense given the central role of United States Trustees in ensuring the integrity of the bankruptcy system.

Assuming that the practical problems associated with conducting an audit can be resolved, the provision as drafted would be costly. The Department has estimated that implementing the audit program contemplated by this section could cost from \$18.6 million to more than \$59 million over five years. This cost is in large part a function of the number audited and the use of independent CPAs. The cost of the audits could easily consume a significant portion of the total sum appropriated to fund the entire United States Trustee program in Fiscal Year 1998. Moreover, the bill provides no funding mechanism to cover these costs.

The use of an audit report is left similarly vague. Copies of the audit reports are to be filed with the Court, but it is uncertain if this would be merely for the purpose of providing a public repository for the report accessible to all parties in interest, or if it is intended that the Court would, *sua sponte*, initiate action based on the auditors' findings.

We recommend that the following changes be made to section 601:

- ° Require the Attorney General to establish a system to audit consumer debtor cases on either a random or targeted basis, but without a minimal prescribed percentage;

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- ° Eliminate the requirement of filing the audit reports with the court;
- ° Provide a civil sanction to ensure debtor's compliance with the audit and defer a section 727 discharge until the U.S. Trustee reports a satisfactory audit instead of placing the burden on the U.S. Trustee to file a complaint to bar the debtor's discharge in the case of noncompliance; and
- ° Provide a source to fund the audits other than assessments upon the affected debtors.

Given the size of the audit program and its cost, the Department also urges the Committee to consider a pilot program for audits that would allow the costs and benefits of various approaches to be considered. In addition, consideration should be given to limiting random audits to chapter 7 debtors.

Section 603. Uniform rules for the collection of bankruptcy data.

Section 603 requires the Attorney General to issue rules prescribing uniform reporting forms for final and periodic reports. The Department supports this provision, but notes two problems. Section 603 conflicts with section 425, which requires the Judicial Conference to create an official form for periodic reports in small business chapter 11 cases. Section 425 should be amended to reflect the role of the Attorney General in promulgating the form of these reports. We also question the provision in this section requiring the Attorney General to maintain final reports in one or more central locations. Currently, all final reports are filed with the courts, and section 603 provides for electronic access through the Internet. We would be happy to work with the Committee to recommend appropriate changes to these provisions.

Section 701. Treatment of Certain Liens.

Section 701 deals with subordination of tax liens under section 724(b) of the Code, and is identical in effect to section 2 of S. 1149, the Investment in Education Act, a bill passed by the Senate on October 30, 1997. Under the proposed changes, ad valorem property taxes would generally be protected from subordination. Reversing current law, expenses of a failed chapter 11 proceeding would not be given preferential treatment over tax liens, with a limited exception. Exhaustion of unencumbered assets would be required before tax liens could be subordinated, and expenses of preserving or disposing of secured property must be recovered from the property (reducing the expenses to which a tax lien would be subordinated).

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We support this provision. The public fisc should not be required to subsidize failed chapter 11 cases by having tax liens subordinated in order to pay administrative expenses of insolvent reorganization proceedings. Moreover, in chapter 7 cases, other unencumbered assets should be used to satisfy administrative expenses and any expenses properly allocable to secured claims should be recovered from the property.

Section 702. Effective Notice to Government.

Section 702 of would amend section 342 of the Code to improve notice to the entities most frequently participating in the bankruptcy process -- governmental units. It would require identification of the agency through which the debtor is indebted; disclosure of identifying information concerning the claim (such as taxpayer identification numbers and real estate parcel designations); and creation of a matrix of addresses of governmental units. In addition, it would give incentives to debtors to use the designated addresses.

We support these provisions. They are in accord with Recommendation 4.2.1 of the National Bankruptcy Review Commission, which urged redress of the current deficiencies in notifying governmental units. This provision would ensure reasonable identification of both the affected government agency and the debtor obligated on the debt. It would also create a mechanism for giving debtors accurate addresses to which notices should be sent. Finally, it would promote compliance with the mechanism by providing exceptions to bar dates and dischargeability when a debtor fails to comply with the prescribed mechanism. We suggest, however, that the reference point in subsection (c) be corrected from notice of the bankruptcy "case" to notice of "the matter or proceeding in respect to which the notice was provided."

Section 703. Notice of Request for a Determination of Taxes.

Section 703 would amend section 505(b) of the Code to provide that a request for prompt audit of a tax return should be sent to the office designated by the taxing authority. Thus, for example, a notice sent to the Secretary of the Treasury in Washington, rather than to the Special Procedures unit of the IRS District Director where the bankruptcy is pending, would not suffice. We support this proposal. However, we are concerned about the potentially draconian effect of failure to provide adequate notice, and suggest that a redemptive provision be included so that errors can be corrected in appropriate cases.

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Section 704. Rate of Interest on Tax Claims.

Section 704 would enact as Section 511 of the Code a new provision relating to the interest rate on, or determining the present value of, a tax claim. Under current law, the court must generally determine the "market rate" under such circumstances. Section 511 would provide that if the holder of an unsecured prepetition tax claim is entitled to interest on such claim, the minimum rate of interest will be the Federal short-term rate rounded to the nearest full percent, determined under section 1274(d) of the Internal Revenue Code for the calendar month in which the plan is confirmed, plus three percentage points. The section 6621(a)(2) rate is also based on the Federal short-term rate, plus three percentage points, but is fixed on a quarterly basis at the rate for the first month of a quarter rather than redetermined monthly. In the case of secured tax claims and administrative tax claims, the applicable nonbankruptcy rate would apply with respect to federal taxes, i.e., the section 6621(a)(2) rate.

We would prefer that the legislation simply fix the interest rate for all deferred tax payments at the applicable nonbankruptcy interest rate. On the other hand, the rate for unsecured taxes under section 704 of S. 625 is merely a minimum rate and does not preclude a taxing authority from insisting on a higher rate. Thus, we would not oppose this provision.

Section 705. Tolling of Priority of Tax Claims Time Periods.

Section 705 would suspend the time periods under the Code pertaining to the priority and discharge of tax claims during the pendency of a prior bankruptcy for the period in which the government was prohibited from collecting the claim, plus six months. We support this proposal, but suggest several modifications, outlined below. The filing of successive bankruptcies should not disadvantage governmental units by reducing their opportunity to collect a tax, and should not result in a more expansive discharge of tax claims for debtors. Adding six months to the suspension period mirrors section 6503(h) of the Internal Revenue Code (26 U.S.C.), and is appropriate given the disruption to collection efforts caused by the filing of a bankruptcy petition. The additional time is needed to get collection efforts back on track.

As noted above, we would suggest several modifications to this provision. First, the time periods applicable to employment and excise taxes should be suspended during the pendency of a prior bankruptcy case. Second, this section should be modified to suspend time periods in which collection was stayed under the terms of a confirmed plan under chapters 11, 12 or 13, plus six

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months. Third, the Internal Revenue Service Restructuring and Reform Act of 1998 gave taxpayers new rights to appeal collection actions that, when invoked, have the effect of staying collection. Thus, the time periods should also be suspended while the IRS is prohibited from collecting as a result of an appeal of a collection action taken under applicable nonbankruptcy law.

Section 707. Chapter 13 Discharge of Fraudulent and Other Taxes.

Section 707 would generally conform the discharge of tax claims in chapter 13 cases to the discharge of such claims available in chapter 7 cases. We support this provision. Under current law, priority tax claims for which a proof of claim is filed must be paid in full pursuant to the plan, and if a proof of claim is not filed, such taxes may be discharged. Taxes attributable to fraud or unfiled returns can be discharged upon completion of all payments under the plan, but many jurisdictions permit plans providing for "zero payment" of taxes, or plans distributing payments covering only small percentages of such claims. Permitting taxes attributable to fraud, or for which returns have never been filed, to be discharged on the basis of a tax evader's commitment to make payments to his or her creditors for three or five years makes bankruptcy a tax haven. In our view, a debtor should be entitled to the same discharge in chapters 7 and 13. Furthermore as provided in section 714, chapter 13 plans should not be confirmed unless prepetition tax returns are filed.

Section 708. Chapter 11 Discharge of Fraudulent Taxes.

Section 708 would deny a discharge to a chapter 11 corporate debtor for taxes that arose because of fraudulent tax returns or an attempt to evade taxes. We support this proposal. Corporations that engage in tax fraud or otherwise attempt to evade taxes should not be entitled to a discharge vis-a-vis those taxes.

Section 709. Stay of Tax Proceedings.

Section 709 would limit the automatic stay applicable to Tax Court proceedings to proceedings regarding a tax liability for a tax period ending before the order for relief, and would clarify that the automatic stay does not apply to an appeal of a decision determining a tax liability of the debtor. We support these proposals. No purpose is served in staying the commencement or continuation of a Tax Court proceeding for taxes incurred postpetition. Moreover, a court of appeals case regarding the liability of a taxpayer for a tax should be allowed to continue to a decision.

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Section 710. Periodic Payment of Taxes in Chapter 11 Cases.

Section 710 would amend section 1129(a)(9)(c) of the Code to provide that deferred payments of tax claims under a chapter 11 plan must be made in installments and to proscribe expressly balloon payments. In lieu of the current five-year payment period measured from the date of assessment, such payments would end on the earlier of five years after the petition date or on the last date on which payments are to be made to unsecured creditors under the plan. In addition, secured tax claims would be treated as priority claims for deferred tax purposes, where such claims would have had priority absent their secured status. We support this provision.

Section 711. The Avoidance of Statutory Tax Liens Prohibited.

Section 711 would resolve litigation over the interaction of section 545(2) of the Code, and the protection accorded certain purchasers of property under 26 U.S.C. §6323 even after a notice of tax lien has been filed. We support the proposal. The purpose of the special treatment for such purchasers is to facilitate the flow of these goods in commerce. Debtors would receive a windfall if section 545(2) of the Code applied to tax liens.

Section 714. Income Tax Returns Prepared by Tax Authorities.

Section 714 would confirm the exception from discharge for taxes relating to unfiled tax returns when substitute tax returns are prepared by taxing authorities. For tax purposes, a tax return prepared by the IRS is not considered a tax return, unless it is signed by the taxpayer. The proposal would confirm that a substitute return prepared by the IRS is not a return for discharge purposes, unless it is signed by the taxpayer. This section further provides, however, that a written stipulation to a judgment entered in a nonbankruptcy court would be treated in the same manner and have the same effect as a signed tax return. We are uneasy at the prospect of having different definitions of "tax returns" for Internal Revenue Code and Bankruptcy Code purposes. Furthermore, stipulation to a judgment represents a level of cooperation much different in degree and kind than the signing under penalty of perjury of a return prepared by a taxing authority. Thus, we do not support the provision equating a stipulated judgment with a signed return. It would also be helpful to clarify that the term "equivalent report or notice" applies only to the extent that state or local tax law provides for the filing of an equivalent report or notice, and has no application for federal income tax reporting purposes.

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Section 715. The Discharge of the Estate's Liability for Unpaid Taxes.

Section 715 would absolve the debtor's estate of liability for administrative taxes after a request for a prompt audit is made in accordance with section 505(b) of the Code. Several courts have held that while a trustee, the debtor, and a successor to the debtor are discharged from liability for administrative period taxes after a prompt audit request is made, the estate remains liable for any taxes uncovered by a taxing authority in a subsequent audit. We oppose the proposal to extinguish the liability of the estate. Section 505(b) already protects the trustee, the debtor and the debtor's successors from liability, and extinguishing the liability of the estate for taxes that it should have reported on its return will result in an unjust windfall for other creditors.

Section 716. Requirement to File Tax Returns to Confirm Chapter 13 Plans.

Section 716 would require chapter 13 debtors to file tax returns due for three years prior to the petition date. Tax authorities are placed at a severe disadvantage in preparing and filing timely proofs of claim when a chapter 13 debtor has ignored his or her tax return filing obligations. Outside of bankruptcy, the IRS will typically ask a delinquent debtor to file tax returns for the prior six tax years. We submit that the Code should similarly require the filing of delinquent tax returns for six years rather than for three years, and we therefore urge that this provision be modified accordingly.

Section 718. Setoff of Tax Refunds.

Section 718 would create an exception to the automatic stay allowing taxing authorities to set off prepetition tax refunds against prepetition tax claims. We support this proposal.

Even when consumer bankruptcy filings were a mere 300,000 cases a year, the cost to the government of filing lift stay motions for relief from the automatic stay in order to effect a setoff of tax refunds would have been significant. With consumer filings now surpassing 1.3 million cases a year, the cost of filing such lift stay motions would be prohibitive. Given the number of cases in which refund offset arises, the solution is to permit taxing authorities to use the administrative processes that apply outside of bankruptcy rather than dealing with the issue on a case-by-case basis using a litigation model.

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In addition to the comments outlined above, the Department urges addition of a new provision in this title: **Tax Year that Straddles the Petition Date**. S. 625 should be amended to include an additional tax-related proposal to clarify the bankruptcy treatment of a tax year that straddles the petition date. For bankruptcy purposes, an income tax liability is incurred on the last day of the tax year inasmuch as a taxpayer's liability for tax cannot be calculated until all income has been accrued or collected, and all deductions have been accrued or paid. Moreover, until the debtor reports its income tax liability, a taxing authority is not in any position to prepare and file a proof of claim. Nonetheless, several courts have held that a tax year straddling the petition date should be treated as partially a prepetition year and partially a postpetition year. In re O'Neill Shoe Co., 64 F.3d 1146 (8th Cir. 1995); In re Pacific-Atlantic Trading Co., 64 F.3d 1292 (9th Cir. 1995); and In re Hillsborough Holding Corp., 115 F.3d 1391 (11th Cir. 1997). Under these decisions, the prepetition portion of the year is treated as a priority tax, while the balance is treated as an administrative tax. These decisions create the opportunity for considerable mischief, particularly if the time for filing a proof of claim will run prior to the due date of the return in question. Furthermore, to the extent that straddle years are treated as prepetition tax years, debtors can stretch out the payment period for the related tax liability for five years under chapter 11, instead of paying the tax in full in cash on the effective date of the plan.

We submit that the Code should be amended to clarify that an income tax liability is incurred on the last day of the tax year for purposes of determining whether a tax is entitled to administrative expense or priority treatment. Clarification is needed because bankruptcy petitions are rarely filed immediately after the last day of the tax year, so that this issue can potentially arise in virtually any case.

Section 801 Amendment to Add Chapter 15 to Title 11.

Section 801 adds a new chapter to the Code to be codified as chapter 15. This chapter would address insolvencies which cut across international borders. We generally support these provisions.

Section 1001. Reenactment of Chapter 12.

Section 1001 reenacts chapter 12 of the Code, pertaining to family farmers. We support this provision.

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Sections 1101-1105. Health Care.

Sections 1101 to 1105 concern bankruptcy in the health care industry. These provisions require an ombudsman to be appointed in every chapter 7, 9 or 11 case involving a "health care business" to monitor the quality of patient care and provide status reports to the court every 60 days. A "health care business" is broadly defined to include everyone from individual doctors to HMO's, hospitals, and nursing homes. These provisions also establish procedures to impose new obligations on private bankruptcy trustees to (i) dispose of patient records and (ii) use best efforts to transfer patients from a health care business that is closing to another facility in the area.

We are concerned about section 1104's requirement that the court sua sponte appoint an ombudsman in every health care case. First, the appointment of an ombudsman is an administrative function that should be vested in the United States Trustee rather than the Court. This would be consistent with other appointments required under the Code. Second, we question whether an ombudsman will in fact be needed in every health care case. We are also concerned that Section 1102 will require the trustee to incur burdensome costs for noticing and disposal of records, and Section 1105 may require the trustee to incur costs for the transfer of patients. Although Section 1103 allows the trustee reimbursement of these expenses as administrative expenses, it is unclear how these costs would be covered if the estate is administratively insolvent.

Section 1227. Extensions.

Section 1227 would amend section 302(d)(3) of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986 to eliminate the deadline for including the judicial districts in the States of Alabama and North Carolina within the United States Trustee system. The Department strongly opposes the amendment because it would retain two separate systems of bankruptcy administration within the country and may be vulnerable to Constitutional attack under the Uniformity Clause.

When Congress made the United States Trustee Program (USTP) a nationwide program in 1986, the date the Program was to commence varied in different judicial districts. Six federal judicial districts in the States of North Carolina and Alabama remain outside the program, and the date for the inclusion of these districts has been postponed until October 1, 2002 - sixteen years after the United States Trustee Program's nationwide expansion. Pub. L. No. 101-650, 317(a), (c), 104 Stat. 5115, 5116 (1992). In these six districts, "Bankruptcy Administrators" and court clerks employed by the judicial branch

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perform many of the functions that are performed by United States Trustees in USTP districts.

This arrangement may not comply with Article I's mandate to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const. Art I., §8., cl. 4. Supreme Court precedent on what "uniformity" means in this context is ambiguous. The leading case on the issue is Hanover National Bank v. Moyses, 186 U.S. 181 (1902), where the court rejected a challenge to the Bankruptcy Act of 1898, which recognized state exemptions instead of establishing a system of uniform federal exemptions. The opinion suggests that Congress can account for differences in state law in the bankruptcy laws without violating the requirement of uniformity. More recently, in Railway Labor Executives' Ass'n v. Gibbons, 455 U.S. 457 (1982), the Supreme Court struck down, as violative of Article I's uniformity requirement, a statute requiring employees of the bankrupt Rock Island and Pacific Railroad Co. estate to receive certain benefits if not rehired by other carriers. According to the Court, "to survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of creditors." Gibbons, 455 U.S. at 473.

Given the lack of clarity on Article I's uniformity requirement and the doubts raised about the justification for maintaining both the USTP and Bankruptcy Administrator programs, additional challenges to the constitutionality of this dual system seem likely. See, e.g., St. Angelo v. Victoria Farms, Inc. 38 F.3d 1525, 1532 (1994); Joelson v. United States, 179 B.R. 857, 864 (N.D. Ohio 1995). In any event, maintaining a special system of bankruptcy administration for just six of the nation's 94 judicial districts is imprudent. No articulated policy justified maintaining the Bankruptcy Administrator program, and its continued existence not only threatens to inspire additional constitutional challenge, but is also contrary to the fair, effective and uniform administration of the bankruptcy laws.

* * * *

Finally, as noted in our comments above, many of the provisions set forth in this bill would impose substantial burdens on the United States Trustee Program. Currently, the Trustees program is fully self-funded through fees. However, to implement the requirements of this bill, the Trustees would be required to expend tens of millions of dollars that will diminish their ability to fulfill their other responsibilities, and this, in turn, will diminish the efficiency of the bankruptcy system. We therefore request that a special appropriation be authorized for each provision that imposes a new burden on the United States Trustee Program.

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Moreover, aside from the new expenditures that will be required as a result of this bill, we believe that any bankruptcy legislation should provide authorization for an increase in filing fees to cover shortfalls, resulting from a decrease in fee generating filings, that the United States Trustee Program is currently facing. We would be happy to work with the Committee to establish the appropriate amount and authorizing language.

We look forward to working with the Committee as it considers these and other issues raised by S. 625. The Office of Management and Budget advises that it has no objection to the submission of this letter from the standpoint of the Administration's program.

Sincerely,

Handwritten signature of Dennis K. Burke in cursive script.

Dennis K. Burke
Acting Assistant Attorney General

cc: The Honorable Patrick Leahy
Ranking Minority Member