Bankruptcy Legistive Update

On Thursday afternoon, Senate Republican and Democratic staff began discussing the previously transmitted Administration/Durbin/Dodd/Sarbanes list of amendments as well as a list of another 30+ amendments sent forward by Democratic (and Republican) Senators for consideration on the bankruptcy bill. Most were bankruptcy related (with the exception of Pay Equity and some intellectual property amendment from Senator Hatch that has never been seen).

The cloture vote was scheduled for Friday morning at 10:00 and Senator Lott had said that, if he did not have a unanimous consent agreement on a manager's amendment and a reasonable list of other amendments to be considered on a recorded vote in place before Friday at 10:00, the cloture vote would go forward.

For about 3 hours, little progress was made as first Lott brought the bill onto the floor for debate, requiring all staff to leave the negotiations to join their bosses on the floor, and then as various Senators visited the negotiating group in Daschle's conference room off the floor, to send messages about the importance of rapid completion of the agreement or the bill would be left to the fate of the cloture vote. Most notable was a visit from Senator Biden sending the message that, unless the list of Democratic amendments requiring a vote was reasonable, he and other Democratic supporters of the bill would be prepared to vote for cloture. Senator Hatch came in to argue that, since he had gotten Kennedy his minimum wage vote, all other Democratic amendments should go away -- especially the ones on gun and tobacco companies in bankruptcy, and pay equity. Senators Lott and Daschle came in for a status report as well.

All were told that, if staff we given time to go through the list of amendments, many could be agreed upon and a limited list of amendments for a vote could be produced. Senators Durbin and Grassley then joined staff on and off for the rest of the evening as the amendment list was considered.

On the issues of greatest importance to the Administration, significant progress was made, although two key issues remain outstanding for a Senator to Senator meeting tomorrow on Friday morning at 9:30. The outcome of those issues should influence our approach to the Senate bill. These issues are summarized below.

Current thinking is that the Administration will not send a SAP. There is insufficient time, after we get word of the Senators decisions this morning, to prepare and clear one. Moreover, we leave ourselves more opportunity for thorough review of the bill before we establish a position and strategy for conference. We can write a letter to the conferees or bill managers before conference if we want.

Nondischargeable Debts.

Subject to final approval by Senator Kyl, staff agreement was reached that effectively eliminated the provision that made nondischargeable debt incurred to pay non-dischargeable debt . Under the agreement, in order for the court to find the debt was nondischargeable, the creditor would have to demonstrate that the debtor paid a nondischargeable debt with a credit card with the intent of then filing bankruptcy and avoiding the otherwise nondischargeable payment. This solution addresses the problem of gaming the system (to which concern we were sympathetic) without significantly sweeping into nondischargeability debts incurred incidentally without any bankruptcy planning.

Subject to final approval by Senator Durbin, staff agreed on a provision concerning debt incurred on the eve of bankruptcy. They would return to the language in current law about what constitutes luxuries and necessaries, extend the period from 60 to 90 days, and leave the cap in the current Senate bill of $400 on luxuries. Since the Administration was prepared to accept making any luxuries nondischargeable so long as there was no cap on necessaries, this is consistent with out position, but we will have to fight hard to preserve it in the House.

Disclosures

Agreement was reached on a package of "clear and conspicuous" disclosure requirements including:

disclosure to the consumer on the monthly billing statement of the time period over which debt would be paid if only the minimum payment were made and the total cost to the consumer, including interest and principal, of paying the balance in full if only the required minimum monthly payments were made

provision to the consumer with the initial disclosure of an easily understandable worksheet to aid consumers in determining their ability to assume more debt

inclusion in a statement in any "pre-approved" credit application that: "Your preapproval ... does not mean that we have reviewed your individual financial circumstances. You should review your own budget before accepting this offer of credit."\

provision to the consumer with the initial disclosure of notice that the consumer is entitled to a copy of his or her credit report in accordance with the Fair Credit Reporting Act.

In addition, they agreed to a Fed-Treasury study of the extent to which consumers would be aided by greater disclosures concerning the security interests taken in their purchases. (This was a substitute for a Sarbanes amendment that would have required new disclosures upon every purchase on which a security interest was taken.)

Reaffirmations

Tentative agreement was reached on the Administration's proposal to make it a violation of the automatic stay (with treble damages) to threaten to file a 707(b) motion, to contest the discharge of a debt, or to repossess collateral to which the automatic stay applies.

In addition, tentative agreement was reached on the Administration's proposal to subject reaffirmations of ***unsecured debts*** to heightened scrutiny by the bankruptcy court (including scrutiny of the course of dealings between the creditor and debtor) and a requirement that the court find by clear and convincing evidence that the reaffirmation was in the debtor's best interest and would not harm the debtor's dependents. In addition, the bill would ban any reaffirmation of unsecured debt that included attorneys fees and costs in the amount reaffirmed.

However, the republicans would not agree to applying the same protections to reaffirmations of secured debt for any individual assets whose value at the time of purchase was less than $500. This provision is thought necessary because, without it, many credit providers will seek to take security interests in all goods purchased with the card (as Sears now does). While it may make sense for a debtor to reaffirm a debt for a major physical asset (e.g., refrigerator, automobile, etc.), creditors who threaten to repossess small ticket items which have no resale value are simply harassing debtors to get debt reaffirmed. Principals will meet this morning to discuss whether to include nothing on reaffirmations, protections for unsecured but not secured assets, or the full adminsitration/Durbin package.

707(b) Abuse Test

The Republican staff agreed to change the threshold for the abuse test from capacity to repay 20% of debts to capacity to repay 30% of debts. *However, without inclusion of the presumptive guidelines (which we have said should not be mentioned until conference), they were unwilling to include the dollar threshold of $5000 for the minimum amount to be repaid under a Chapter 13 plan if a debtor is to be shifted under the abuse test. More importantly, they were unwilling to revise their creditor standing provision. We have insisted that creditor standing be only granted to creditors who are seeking to show abuse through showing that the debtor has the capacity to repay. However, under existing case law, many other basis exist for showing abuse including, for example, repeat filings. We have argued that creditor motions have a potential to be particularly coercive, so we are only Other prepared to allow them on the basis of the debtor's capacity to repay. Therefore, treatment of the Administration's 707(b) proposal will be considered by Senate principals Friday morning.*

Other Significant Amendments

Child Support Collection. The National Association of Attorney Generals sought revisions to the existing child support and alimony language in the Senate bill, which is designed to enhance the collection of these payments in bankruptcy. The goal of the changes, we are told, is to enhance the capacity of the state, which has made welfare payments, to seek recovery from the "deadbeat" parent/spouse, of the money they have advanced. We do not yet have a copy of the amendment and women's groups have not seen it, so we remained silent. It is unclear if the Democrats will allow it to be included in the manager's amendment. We were silent.

Definition of Household Goods. Agreement was reached which will allow the FTC to create a new definition, solely for the purpose of bankruptcy, rather than using the existing FTC definition, to which women and children's advocates have objected.

Retirement Income. Agreement was reached on making additional forms of retirement savings exempt assets. Currently, 401(k)s are exempt but IRAs, for example, are not.

Credit Counseling. Agreement was reached on revised provisions that should pose less of a bar to bankruptcy filing that the current provisions which require completion of counseling before a petition can be filed. The changes made satisfy the national foundation of consumer credit counseling agencies and address major DoJ concerns.

Farmers. Three noncontroversial changes were made to family farm bankruptcy law.

Kids Expenses. A Agreement was reached on a clarification to the disposable income definition to be clear that income devoted to the reasonable support of kids was excluded.

Drunk Driving. Agreement was reached on including drunk boating damage awards in the current category of drunk driving awards that are non-dischargeable in bankruptcy. In addition, drunk driving awards were given priority in bankruptcy. An amendment sought by MADD, that would have said that any drunk driving liability awards received by family or the debtor could be exempt from debtor's assets for calculating ability to repay, probably will be withdrawn.

Financial Contract Netting. This proposal, supported by Treasury, was included in the bill, unaltered.

Key Votes

Among the items which could be voted on are:

Miscellaneous bankruptcy concerns about manufactured housing (big AARP issue but we disagree), cramdowns, and the chapter 13 superdischarge for fraud
The Feinstein amendment on high risk lending (which we reviewed and rejected privately)
Dodd amendments on unsolicited credit to persons under 21 and to make exempt assets et aside for post-secondary education
minimum wage
a Feingold amendment to add a factor in the abuse test to consider whether the debtor used prudent underwriting
a Reed amendment to prohibit credit card companies from terminating card holders who pay their balance in full
a specter amendment on nonprofits in bankruptcy (aimed to protect a Philadelphia hospital)
D'Amato on ATMs
Gramm on the Homestead Exemption
Hatch on intellectual property
Leahy on nondischargeability of tobacco fraud liability awards
Torricelli on bankruptcy of gun manufacturers
Boxer on Pay Equity

September 8, 1998

MEMORANDUM FOR HILLARY RODHAM CLINTON

FROM: NICOLE RABNER

SUBJECT: BANKRUPTCY REFORM

Legislative Update

As we anticipated, last Thursday (9/3), Senator Lott brought up the Senate bankruptcy bill for consideration and debate. Senator Kennedy, however, objected to the motion to proceed to debate the bill. Lott then filed a cloture petition; the vote on cutting off debate and proceeding to consideration of the bill is expected tomorrow (9/9). If Lott is successful and the Senate considers the underlying bill, we expect Senator Kennedy to offer an amendment to raise the minimum wage. In addition, other Democrats may bring up amendments on HMOs, campaign finance, and pay equity, as well as a host of relevant but non-germane bankruptcy amendments. Senator Daschle said Democrats likely would oppose a cloture motion that would not allow full debate on the bill, although it is unclear if that fight will be held on tomorrow's expected vote on the motion to proceed or on an effort to choke debate on the underlying bill later next week. Republicans and credit card lobbyists report that they have lined up democratic Senators to vote for cloture. *The NEC advises that if the Senate does get to a vote on the underlying bill, it will receive broad support.*

Senate Bill

As you know, the current Senate bankruptcy bill is significantly better than the House bill, although it is still flawed in three significant ways. First, while the test it establishes for determining which debtors should be denied access to Chapter 7's full and immediate discharge provides courts with appropriate flexibility and discretion, the guidelines have a threshold that is too low -- debtors must have the capacity to repay 20% of their debt over three years. (In order to make sure that debtors who are denied access to Chapter 7 will successfully complete a Chapter 13 repayment plan, we prefer a threshold of 30%, so we're now asking for 35%.) Second, the bill creates categories of new nondischargeable debts owed to credit card companies that the Administration does not believe rise to the level of public priority that would justify precluding their discharge in bankruptcy. (However, *the NEC and DOJ experts have concluded that the Senate version largely eliminates the problem of competition with child support and alimony through a variety of exceptions and priorities, so we cannot credibly make a child support and alimony argument about nondischargeable debts.*) Finally, and most important, the bill simply is not balanced. It asks greater responsibility of debtors but not of creditors. The Administration is pressing for additional consumer disclosures and protections against coercive practices.

Expected Manager's Amendment to Senate Bill

The bill manager, Senator Grassley, is preparing a manager's amendment aimed at addressing at least some of the key Democratic concerns with the substance of the bill. Our strategy has been to stay closely aligned with the Democratic caucus, insisting that any discussions we have with Republican staff include Democratic staff. NEC, Leg Affairs, and Treasury joined Daschle, Durbin, Dodd, and Sarbanes staff in a meeting last Wednesday with Grassley and Hatch staff to present a single list of Democratic objectives for the manager's amendment. We expect Grassley and Hatch to accept some but not all of the Democratic amendments.

Attachment
9/4/98 CQ Article

CQ's WASHINGTON ALERT 09/04/98

SENATE FLOOR: SUPPORT FOR BANKRUPTCY OVERHAUL BILL HAS STRINGS

By Matthew Tully, CQ Staff Writer

Democrats yesterday blocked an attempt by Republicans to consider a bill that would make sweeping changes to consumer bankruptcy laws, stalling a measure that has received significant support from the credit card and banking sectors and is a priority of Majority Leader Trent Lott, R-Miss.

Upset that a number of other high-profile legislative issues are not moving forward, Democrats objected to a request by Lott that would have paved the way for initial consideration of the bill (S1301). Lott responded by filing a cloture motion and scheduling a vote next Wednesday. A positive vote would allow the Senate to begin formal consideration of what is now expected to be a contentious piece of legislation.

Supporters of the bill say it is needed to address a rate of bankruptcy filings that has skyrocketed in recent years because it has become too easy and, in some cases, too beneficial to walk away from one's debts.

Members of both parties agree changes need to be made to the bankruptcy code, but Democrats argue the bill does not adequately consider the needs of people who find themselves in dire financial straits and does not hold creditors responsible for reckless or irresponsible lending practices.

"We are deeper in debt as a country and the credit card companies are luring people deeper in debt," said Edward M. Kennedy, D-Mass.

When consideration of the bill does begin, Democrats are expected to offer a number of contentious amendments.

Kennedy has promised to offer an amendment that would raise the minimum wage by $1 over the next two years -- to $6.15 an hour in 2000. The well-worn debate could prove to be a stumbling block, as Minority Leader Tom Daschle, D-S.D., said Democrats likely would oppose a cloture motion that would not allow full debate on the bill.

"Our concern is that we will not even be able to offer relevant amendments," he said. "We will oppose it as long as that is the case."

The bill's Democratic sponsor, Richard J. Durbin, Ill., said he wants to make a number of other changes to the measure, including: one to make credit card companies responsible for poor lending practices that contribute to financial problems; one to make borrowers fully aware of the dollar cost of borrowing a certain amount of money; and one to give child support and alimony debts priority over other liabilities.

6-22-98

Copied
Sperling
Katzen
COS

THE WHITE HOUSE

WASHINGTON

June 20, 1998

MEMORANDUM FOR THE PRESIDENT

FROM: PHILLIP CAPLAN Phil

SUBJECT: Bankruptcy Reform Legislation

Gene Sperling and Sally Katzen have sent you a lengthy memo seeking your approval of an Administration proposal on bankruptcy reform. Last week, the House passed, by a veto-proof majority, a bankruptcy bill that the Administration strongly opposed. NEC proposes to advance our proposal quickly, in hopes of influencing the Senate bill, which is better than the House bill, but still flawed. There is significant legislative momentum here because of the rising number of bankruptcies, the potential for abuse in the system, and a well-financed credit card industry campaign. ***All of your advisors, both in the WH and the Cabinet, agree on the proposal, which is the product of an NEC interagency process, and think you should move forward with it.***

Elements of proposal:

- Limitations on access to Chapter 7 - current law places little limit on a debtor's access to Chapter 7, though some circuit courts find it is "substantial abuse" of Chapter 7 if a debtor can pay 20% of their unsecured debts over five years. The Senate bill reflects this circuit court approach as does our proposal, which gives bankruptcy courts discretion to determine whether or not a debtor's use of Chapter 7 is abuse and lays out criteria for a "presumption of abuse" (ability to repay 30% of debts or specified amount over five years).

- New categories of nondischargeable debts - both House and Senate bills broaden the categories of nondischargeable debt, which, as you know, would have a large impact on child support and alimony payments. In short, our proposal calls for keeping current law as is and permitting a new category of nondischargeable debt in only one area: credit card debt for luxuries incurred within 90 days of declaring bankruptcy -- many debtors run up their credit cards just prior to declaring -- but without a cap on necessary expenses (*e.g.*, groceries, school clothes). Although both bills attempt to mitigate the impact of broadening the categories in other areas, women's groups maintain, and your advisors concur, that new nondischargeable debt will compete with other existing nondischargeable debt and therefore argue to maintain the status quo.

- Additional consumer protections against predatory creditor practices - your advisors propose additional protections so the bill won't further tip the balance to creditors. Elements include: (i) requiring courts to make debtors prove there is a compelling reason for debtors to reaffirm a debt; such debts survive bankruptcy and creditors often coerce debtors to reaffirm them; (ii) requiring the payment of unsecured, nonpriority debt where the terms/time period were not disclosed clearly to the debtor (e.g., credit card interest) only after other unsecured, nonpriority debt is repaid.

__✓__ Proceed with proposal ____ Discuss

THE WHITE HOUSE

WASHINGTON

June 18, 1998

MEMORANDUM TO THE PRESIDENT

FROM: GENE SPERLING
SALLY KATZEN

RE: BANKRUPTCY REFORM LEGISLATION

Last week, the House passed, by a veto-proof majority, a bankruptcy bill despite an Administration statement of strong opposition. A better, but still flawed, bill (voted out of committee 16-2) may be taken up by the Senate before the July 4th recess or soon thereafter. Both bills were changed recently to address concerns that you, the First Lady, and others have raised about their impact on debtors' capacity to pay child support and alimony, although some problems still remain.

After an NEC interagency review, your advisors have reached a consensus that some bankruptcy reform is important. These bills contain many provisions that are beneficial, including a cap on state homestead exemptions, debtor education pilots, penalties for unjustified creditor activities, measures to discourage bad-faith repeat filings, and provisions to improve data collection and audit procedures. However, certain controversial provisions of the current bills need significant changes to satisfy our objectives and concerns. **We propose to advance quickly an Administration proposal in hopes of influencing the Senate bill on the floor and giving the Administration greater leverage in conference.** The proposal would address three issues: (1) limitations on access to Chapter 7; (2) new nondischargeable debts and their impact on child support and alimony payments; and (3) new provisions to protect against coercive creditor behavior and to require more responsibility from creditors in extending credit. The group also has identified alternatives to parts of this proposal on which we could compromise, if necessary.

I. BACKGROUND

Rising Consumer Bankruptcies: Despite what Goldman Sachs recently called "the best economy ever," personal bankruptcies have continued to rise sharply, from roughly 800,000 in 1994 to nearly 1.4 million in 1997. Recent figures for the first quarter of 1998 showed another

20 percent increase over 1997's pace.

Disputed Causes: There is much dispute about the cause of this increase, but little definitive evidence. Creditors assert that lawyer advertising, reduced social stigma, and increased information about the financial advantages of bankruptcy have encouraged an increasing number of consumers to walk away from debts they could repay. Consumer advocates argue that lenders have irresponsibly extended too much credit to families who are ill-prepared to handle it, and that most bankruptcies happen when unexpected events push such a family over the financial edge; indeed, rising bankruptcy rates track closely rising levels of unsecured debt, although debt burdens have actually dropped due to lower interest rates.

Potential for Abuse: Under current rules, some debtors with high incomes walk away from their debts entirely, even when they have the capacity to repay at least a portion of those debts; other debtors file repeatedly without any intention of completing bankruptcy, for the purpose of delaying bona fide collection activities; and generous state exemptions (including unlimited homestead exemptions in eight states and exemptions for items like race horses and silver spoons in Virginia) prompt some to shift assets to exempt categories prior to a bankruptcy filing to avoid making payment to any unsecured creditors. Consumer advocates argue that these cases are not the norm and should not prompt limits on those who genuinely need bankruptcy's fresh start.

Consumer Impact: Regardless of who is to blame, **higher levels of debt charge-offs appear to raise the cost of credit for everyone.** One industry study suggests that bankruptcies cost every American household between $300-400 per year. Higher credit costs disproportionately fall on lower-income families, since they are more likely to carry a balance on their cards. While in the past credit card interest rates did not always rise and fall with market rates, the industry is now more competitive, so that many believe that, over the long run, reduced bankruptcies are likely to translate to lower interest rates and increased access to credit for those who pay their bills.

Legislative Momentum: The popularity of these bills can be explained by the system's vulnerability to abuse and the apparent consumer costs, as well as an extremely effective and well-financed industry campaign and legislators' fears of being labeled protectors of deadbeats.

II. LIMITATIONS ON ACCESS TO CHAPTER 7 BANKRUPTCY

Current Law: Today, there is little limit on debtors' access to Chapter 7's full and immediate discharge of debt (with virtually no payments to unsecured creditors); however, in some circuits, courts find, on their own motion, that it is "substantial abuse" for a debtor with the ability to repay 20% of their unsecured debts over three years, after taking account of all necessary expenses, to go through Chapter 7 rather than a Chapter 13 repayment plan,

House and Senate Bills: Both bills would require those with the capacity to repay a portion of their debt to do so under a Chapter 13 plan. We opposed the House bill because it determines access to Chapter 7 under a rigid "means test" that does not take into account the unique circumstances of individual debtors. The Senate approach is more flexible, building on the abuse test in use in some circuits. The Senate bill would authorize a bankruptcy judge to apply this test to any debtor with income above the median and, for the first time, allow creditors to file the motion seeking a determination of abuse. Creditors would have to pay debtors' attorneys fees, if their filings were not 'substantially justified' or were brought to coerce a debtor to waive a right.

Administration proposal: We propose a variation on the Senate bill whereby **the bankruptcy court would have discretion to determine whether or not a debtor's use of Chapter 7 is abuse; however, there would be a presumption of abuse if a debtor has an income above the median and the capacity to repay either at least 30% of her unsecured, nonpriority debts or some specified amount (such as $5000) over three years.** (No debtor would be denied access to Chapter 7 unless she had the ability to repay at least $50 a month in unsecured, nonpriority debt. Any lesser amount is too small to merit the Chapter 13 administrative costs or to risk the chance that the creditor was pursuing the motion to coerce the debtor to forgo another bankruptcy right.) We also would provide that, if a debtor moved more than $50,000 from nonexempt to exempt assets within one year of the filing, she would be subject to a presumption of abuse, regardless of income. In determining a debtor's capacity to repay, we propose to explicitly exclude luxuries (e.g., expensive cars or boats) from necessary expenses.

These presumptive guidelines could be overcome if the court determined, e.g., that the debtor faced unusual but necessary expenses or could not be expected to maintain reliably her current level of income. Such presumptive guidelines have proven to be highly effective in promoting uniformity and fairness in establishing child support award amounts. Since the average debtor under Chapter 13 repays 20% of her debts and has income below the national median, those who meet this higher threshold are the most likely to succeed under a repayment plan.

III. NONDISCHARGEABLE DEBT AND ITS IMPACT ON CHILD SUPPORT AND ALIMONY

The Bankruptcy Code makes debts nondischargeable only where there is an overriding public purpose, as with child support, alimony, educational loans, tax obligations, or debts incurred by fraud. To address growing concerns about gaming of the system, both bills broaden the categories of nondischargeable credit card debt, although the largest new category was dropped and the remaining two narrowed. Moreover, as consumers use credit cards for new purposes (e.g., groceries or paying student loans), additional credit card debts become dischargeable. This Administration envisions -- in fact, encourages -- greater use of electronic commerce, so we do not want bankruptcy discharge rules that discourage credit card companies from providing new opportunities for consumers to have the convenience of credit card payment. However, the provisions in these bills creating new nondischargeable debts raise two questions: (1) Do the additional debts made nondischargeable rise to the same level of public priority as other nondischargeable debts? and (2) What impact does the protection of new categories of debt have on the ability of the debtor, post-bankruptcy, to repay existing nondischargeable debts?

Debts incurred to pay other nondischargeable debts.

Current law: A credit card debt incurred to pay federal taxes is nondischargeable, to prevent "gaming" by paying off nondischargeable debts with a credit card which will be discharged.

House and Senate bills: Both make a debt incurred to pay any nondischargeable debt nondischargeable, although the Senate effectively eliminates the provision if the debtor is a single parent or owes child support and/or alimony.

Administration Proposal: We propose that the **current law remain unchanged**; however, if a debtor paid a nondischargeable debt with a credit card, it would be a factor in determining whether the debtor's use of Chapter 7 was abuse.

Debts incurred in the period immediately before bankruptcy.

Current Law: Debts for luxuries over $1000 owed to a single creditor within 60 days of bankruptcy are nondischargeable. There is evidence that this and other anti-fraud provisions do not prevent some debtors from taking the opportunity to run up debt before filing bankruptcy.

House and Senate Bills: Both would make all debts incurred within 90 days of bankruptcy for luxuries presumptively nondischargeable. In addition, they would make presumptively nondischargeable debt above ($250 in the House; $400 in the Senate) per credit card for necessaries during the same period.

Administration Proposal: We propose to agree to make **debt for luxuries within 90 days of bankruptcy presumptively nondischargeable; however, a cap of $250 or $400 on necessary expenses incurred prior to bankruptcy is inappropriate.** One can easily imagine a family, in the months prior to bankruptcy, paying for rent, school clothes, and even groceries on their credit card. Courts can easily compare current spending patterns to prior spending and determine whether charges are truly for necessary expenses.

Child Support and Alimony Considerations

The bills have seven new provisions designed to either mitigate the impact of the new nondischargeable debt on child support and alimony or to give child support and alimony additional protections in and after bankruptcy. Some experts argue that the benefits provided by these additional provisions outweigh any modest harm to child support and alimony payments that remains from the nondischargeability provisions. Moreover, if needs-based reform is done right and shifts only those with the capacity to repay, as we propose, it will likely enhance the collection of these payments, as debts in Chapter 13 are repaid under the supervision of the bankruptcy court. On the other hand, the women's groups still oppose these bills, arguing that there is no way to mitigate fully the consequences of the expanded categories of nondischargeable debt, which enhance competition for the debtor's limited funds. Moreover, these provisions, which focus only on child support and alimony, do not address our policy concern that new nondischargeable debt will compete with other existing nondischargeable debts, such as education loans. For these reasons, our proposals would allow only one category of new nondischargeable debt (luxuries purchased 90 days before bankruptcy); for the remaining categories, we propose to leave current law or address the problem a different way.

IV. ADDITIONAL CONSUMER PROTECTIONS AGAINST PREDATORY CREDITOR PRACTICES

Your advisors are particularly concerned about the unequal bargaining power of the creditor and debtor and how the changes in bankruptcy rules could further shift the balance and create opportunities for coercion and harm. To address this concern, and to ensure that legislation requires responsibility of both debtor and creditor, we propose new consumer protections.

Reaffirmations of Unsecured Debt

Although debtors in Chapter 7 have a right to have their unsecured debts discharged, some debtors reaffirm debts. While there may be some circumstances in which reaffirmation is in the debtor's best interest (e.g., as a condition of obtaining credit to keep open a small business), those cases are few. The risk is real, however, that debtors are pressured into reaffirming their debts by aggressive creditors. After Sears recently paid large penalties for such practices, another Bankruptcy Judge (Fenning) said she scrutinized her court records and found evidence of widespread coercive reaffirmations. Since reaffirmed debts survive bankruptcy, they compete with child support and alimony after bankruptcy. Eliminating coercive reaffirmations also would help to reduce the current level of competition child support and alimony payments face.

Current Law: For a reaffirmation to be valid, the creditor must provide required disclosures and the court must determine that the reaffirmation does not impose an undue hardship on the debtor or a dependant and is in the debtor's best interest; however, an affidavit of the debtor's attorney to that effect suffices.

House and Senate Bills: No related provisions.

Administration Proposal: We propose to require that the court itself find that there is a compelling reason for the debtor to reaffirm an unsecured debt, without reliance on counsel affidavits. We also propose to bar reaffirmation of debts that add attorneys' fees and costs to the debt, to increase penalties on attempts to enforce invalid reaffirmations, and to clarify that creditors may not threaten to file motions alleging abuse of Chapter 7 or solicit a reaffirmation after the automatic stay is imposed.

Credit Card Minimum Payment Disclosure

We also believe that some signal should be sent to creditors about lending practiees that entice debtors to get further and further into debt.

Current Law: Most debtors believe that by making the minimum payment on their credit card they are slowly working off their debt. However, depending upon the interest rate, they may be falling further and further behind. Creditors are increasingly offering minimum payment plans that amortize debt over decades, if at all.

House and Senate bills: No related provisions.

Administration Proposal: We propose a process for subordinating unsecured, nonpriority debt if the creditor did not disclose clearly to the debtor the time period over which the debt would amortize at the minimum payment level. The subordinated debt would be paid, in Chapter 7 or 13, only after all other unsecured, nonpriority debt. It most cases, this means it will not be repaid.

Other Non-Bankruptcy Steps to Improve Consumer Credit Practices

We also are exploring whether there are other non-bankruptcy steps that we can take to clamp down on predatory lender practices and better help consumers to understand their own borrowing. We have consensus on a proposal that requires all lenders to disclose the time period over which debt is amortized by minimum payments. This proposal, and others under review, fall under the jurisdiction of other committees, so it is not feasible to insist that Congress include these proposals in the bankruptcy bill at this time. However, we might unveil these proposals in connection with a campaign to educate consumers about the use of credit, using the bully pulpit as we have done to encourage retirement savings.

V. ADVISORS' RECOMMENDATIONS

All your advisors recommend we proceed as described, including CoS, NEC, Counsel, OPL, OLA, OMB, CEA, DPC, First Lady, DoJ, Treasury, HHS, Commerce, and Education.

- The NEC believes that requiring greater responsibility of both creditors and debtors is the best way to address the "unclean hands" of some of the legislation's proponents.
- Treasury emphasizes that needs-based reform will decrease the cost of, and increase access to, credit for those debtors who do pay their bills, by limiting opportunistic bankruptcy among those higher income debtors who do not.
- CEA believes nondischargeability provisions should not prevent agreement on a bill which strengthens child support and alimony in other ways, particularly if the nondischargeability provisions are targeted to address 'gaming' of the bankruptcy system.
- DoJ supports the plan and stresses that other provisions of these bills, like the cap on state homestead exemptions, measures to discourage bad faith repeat filings, and provisions to improve data collection and audit procedures, are important reforms.
- OPL believes that, while consumer advocates oppose any bill, reforms limiting access to Chapter 7 and stemming coercive reaffirmations appear valid. OPL wants to see us fight for aspects of our proposal that protect against any impact on child support (before or after bankruptcy) of new nondischargeable credit card debt.
- DPC and the First Lady's Office strongly support advancing proposals that achieve more balanced reform by calling for responsibility on the part of the creditor as well as the debtor, and recommends that we continue to focus on the child support issue to ensure that protections in this area are as strong as possible.
- OLA stresses the popularity of bankruptcy reform and advises that we advance proposals that have a realistic prospect of inclusion, or we may find ourselves faced with overwhelmingly popular legislation that fails to satisfy our announced concerns.

VI. DECISION

_____ **PROCEED AS DESCRIBED**

_____ **LET'S DISCUSS**

June 18, 1998

MEMORANDUM

TO: Mrs. Clinton
FROM: Nicole Rabner
RE: Bankruptcy Reform

Attached please find the memorandum prepared for the President's review and action on pending bankruptcy reform legislation. (I have also attached the NEC briefing paper that they provided as background for your meeting, because it describes the issues in fuller detail.) The NEC is, as you know, seeking the President's approval to advance quickly to the Congress the Administration's alternative proposal, in the hopes of influencing the process and enhancing our credibility for a possible fight in conference.

Our principal concerns are that our proposal: (1) protects child support and alimony collection; and (2) ensures that bankruptcy reform is balanced, *i.e.* that it demands responsibility from both debtors and creditors. The consensus proposal outlined in the memorandum does a good job of accomplishing these goals (in no small measure because of your involvement and outspokenness). What is not made clear in this memorandum is the Administration's bottom line, *i.e.* where we are willing to negotiate and where we are not. You will note in the recommendation section of attached memorandum that the Administration is divided on this point. The economists (Treasury and CEA) believe that the "means testing" provision (moving higher-income people from Chapter 7 to Chapter 13) is a critical way to crack down on abuse in the system and is a "first order" issue, while the nondischargeability issue is less important (and, they argue, overstated by opponents). Others, including the DPC and Maria Escheveste, worry about real world repercussions, as well as political awkwardness, of embracing provisions that could weaken child support collection (and collection of other debt of "public priority"). Experts argue that at some level any of these reforms will do that, since there is no way to mitigate fully the consequences of expanding the categories of nondischargeable debt and thereby creating enhanced competition for the debtor's limited funds, particularly post-bankruptcy.

As you know, under intense pressure from you and others, the House and Senate have both improved their legislation on this score, narrowing the circumstances under which child support would be affected and adding "sweeteners" to the child support community. These sweeteners include:

- Elevating priority of child support and alimony in bankruptcy distributions under Chapter 7, making it more likely the child support will be paid in the 5 percent of Chapter 7 liquidations that have assets to distribute.
- Making an exception for child support to general rule that bankruptcy creates an automatic stay on liens, (California district attorneys praise this provision because it would make it easier for local agencies that have paid welfare, for example, to recoup their payment from parents that owed child support or alimony).

- Clarifying that child support obligations surviving bankruptcy are collectable from exempt assets.
- Requiring debtor to be current on family obligations before Chapter 13 plan confirmation and discharge.

Some experts argue that, in addition to these added provisions, "means testing," if done right (by only moving debtors with a capacity to repay signficant debt from Chapter 7 to Chapter 13), may actually help child support collection, as these debtors would be repaying their debt under a supervised repayment plan (Chapter 13).

Some argue that, taken as a whole, reform could be a net plus for child support collection. Others, of course, disagree. The real remaining danger, I believe, is that we may enter these negotiations without a clear sense of where we would draw the line and walk away. While our proposal is balanced, we are, of course, unlikely to get everything we put forward. While it is prudent to work with the Senate to improve this bill, we may also want to (1) develop our bottom-line position; and (2) send a strong signal that we have considered these issues carefully and do not want to see a slippery slope to the House-passed version, which we have said we "strongly oppose."

Summary of NEC Proposal for Administration Bankruptcy Reform Alternative:

- Advance our own version of "Needs Based" reform (giving bankruptcy courts significant discretion, but supplying presumptive guidelines for ineligibility for Chapter 7 -- a person with over 100 percent of median income and an ability to repay 30 percent of unsecured debt).
- Agree to make presumptively nondischargeable all luxury purchases incurred 90 days prior to declaring bankruptcy. (NOTE: this is the only category of nondischargeable debt that expanded in our proposal -- both the House and the Senate expand others).
- Reject making nondischargeable any amount of "necessary expenses" or credit card debt incurred to pay nondischargeable debt.
- Advance strong restrictions on reaffirmations, making it harder for credit card companies to coerce people into agreeing to repay debts they don't have to repay and that would compete with child support post-bankruptcy.
- Subordinate debt (i.e., make it a very low priority) of credit card companies that fail to make clear to consumers how long it would take to pay off their debt by following the "minimum monthly payment" plan.

June 17, 1998 7:00pm

MEMORANDUM

TO: Elena
FR: Nicole
RE: Bankruptcy memo update

NEC is still awaiting comments to the bankruptcy memo to the President. CEA has weighed in strongly to add two things to the memo to soften the nondischargeability section: (1) sentences explaining the rationales for the provisions in the current legisation, *e.g.* making credit card debt incurred to pay nondischargeabile debt nondischargeable will cut down on "gaming the system"; and (2) descriptions of our "fallback positions" on nondischargeability, arguing that as constructed, the memo suggests that we would not negotiate beyond the position the Administration would advance. I told Sarah that I didn't object to adding "rationales" although I thought they were fairly obvious, but that I did object to outlining specific fallback positions. This, I believe, changes the purpose of the memo and surely the meaning of one of the last lines, "all your advisors recommend we proceed as described." I thought that line referenced everyone's feeling that there is urgency to "get our consensus positions under consideration," not agreement on how exactly to negotiate and where to draw the line (which is not spelled out). Diana weighed in similarly. Sarah is awaiting Sally's reaction.

NEC DEPUTIES MEETING
BANKRUPTCY – PART II
June 10, 1998

Outline

I. **NON-DISCHARGEABILITY PROVISIONS AND CHILD SUPPORT CONCERNS.** [See DoJ attachment to 6/4/98 Deputies memorandum for more detail and analysis.]

A. **Debt incurred to pay nondischargeable debt**

1. Current Law: Debts incurred to pay nondischargeable federal taxes are nondischargeable.

2. Proposed Changes and Rationale:

- House: Debts incurred to pay all nondischargeable debts are nondischargeable and shall have 10th priority.
- Senate: Debts incurred to pay all nondischargeable debts are nondischargeable, except that debts incurred by single parents or debtors who owe child support and alimony are nondischargeable only if the creditor can demonstrate that the debtor "intentionally incurred the debt to pay the nondischargeable debt." (Assume means "intentionally sought to make the debt dischargeable," since one cannot unintentionally pay a bill.)
- Rationale: Prevents pre-bankruptcy gaming by debtors; treats similarly situated debtors (with nondischargeable debts) similarly, regardless of whether one was wise or lucky enough to pay off that debt with a credit card.

3. Assessment:

- Significant complaints about this provision could call into question the current law from which federal tax collection benefits.
- There is merit to treating similarly situated debtors similarly, although the bankruptcy code violates this principle in many places.
- The "intent" standard makes sense theoretically, but, as applied, effectively makes the provision meaningless, as intent is so difficult to prove. If included, there is no reason to limit it to single parents and debtors who owe child support.
- No evidence of significant intentional efforts of debtors to avoid

nondischargeable debt by paying such debt with credit cards.

- The House provision, which gives all debt incurred to pay nondischargeable debt 10th priority, could give priority to a debt incurred to pay an underlying nondischargeable debt that does not get priority. Debt should not gain priority because it was paid with a credit card. (Technical fix possible.)

B. <u>Debt incurred just prior to bankruptcy</u>

1. <u>Current Law:</u> Debts owed to a single debtor, aggregating more than $1000 for "luxury goods and services," incurred within 60 days of bankruptcy are presumptively nondischargeable. Thus, all debt for "necessaries" and up to $1000 for "luxuries" within that time period are dischargeable. In practice, the presumption can be overcome if the debtor demonstrates that, at the time she incurred the debt, she had reason to believe that she could repay, e.g., job loss occurred after debt was incurred.

2. <u>Proposed Changes and Rationale</u>:

   - <u>House:</u> Debts owed to a single debtor, incurred within 90 days of bankruptcy, are presumptively nondischargeable, except for "necessaries" of up to $250. Thus, all luxuries and necessaries of over $250, incurred within 90 days, are nondischargeable.
   - <u>Senate:</u> Same except slightly different definition of "necessaries" and cap of $400. (May compromise with Durbin, who wants $1000 cap, by using $750.)
   - <u>Rationale:</u> Currently, too easy for debtor to run up debt (vacations, jewelry, etc.) knowing that she will soon file for bankruptcy. Since hard to prove intent, time period is best proxy. Recall that cap on spending is to a single creditor, so that debtor with multiple credit cards can incur much more just prior to bankruptcy.

3. <u>Assessment:</u>

   - It is difficult to defend the current law exemption for up to $1000 of luxury goods, except by mentioning the impact of new nondischargeable debt on other nondischargeable debt like child support, taxes, and educational loans.
   - However, the cap on "necessaries" of $250 or even $400 is obviously too low. Easy to imagine spending much more for food, school clothes and supplies, and even rent, in months prior to bankruptcy when trying to keep afloat using credit cards after job loss or major unexpected medical bills. Unclear what the proper

cap on "necessaries" would be, if any, to balance between preventing abuse and protecting those truly in need of a fresh start.

- Would be administratively complex to place the cap on aggregate debt, rather than debt to a single debtor.

C. <u>Debt incurred without a reasonable expectation or ability to repay</u>

Note: This provision, which we judged to be the most offensive and to have the greatest impact of any of the nondischargeability provisions, was never in the Senate bill. The manager's amendment to be offered on the House floor today will eliminate this provision from the House bill as well.

D. <u>Assessing the non-dischargeability provisions in general</u>

- Do the additional debts made nondischargeable by these bills rise to the level of public priority akin to other nondischargeable debt?
- What impact does the protection of new categories of debt have on the ability of the debtor to repay other categories of nondischargeable debt, e.g., child support and alimony, educational loans, taxes?

E. <u>Impact of Needs-Based Bankruptcy on Child Support Collection</u>

The House bill, as currently written, could move to Chapter 13 some debtors who may fail to complete required repayment plans, and who would return to Chapter 7 with a diminished ability to repay their nondischarged debt -- including child support and alimony. Not all limitations on access to Chapter 7 would have this result. In fact, if debtors truly have the ability to repay a portion of their debt, after taking into account family obligations, a supervised repayment plan under Chapter 13 rules could result in more reliable payment of child support and alimony than would the unsupervised situation after a Chapter 7 discharge.

F. <u>Provisions to enhance the collection of child support and alimony</u>

1. <u>Clarify ability of bankruptcy courts to accelerate repayment of family support arrearages in a Chapter 13 plan</u>. (House and Senate.) This ability currently exists. Provision designed to clarify impact of other bill provisions.

2. <u>Exception from the automatic stay for governmental action to collect child support</u>. (House and Senate.) This provision would make it easier for local agencies that have paid welfare, for example, to recoup their payments from parents that owed child support or alimony. California

District Attorneys praise provision. Likely to have the greatest impact of all these provisions.

3. <u>Clarify that child support obligations surviving bankruptcy are collectable from exempt assets</u>. (House and Senate.) Helpful clarification.

4. <u>Priority for family obligations post-bankruptcy</u>. (House only.) While well intended, this does not sufficiently address post-bankruptcy concern about additional nondischargeable debts. (1) Has no impact where no entity has authority to enforce the priority, so nothing will prevent a debtor from responding to a creditor bill for a nondischargeable debt by paying it instead of first paying child support arrearages; and (2) has no impact in cases where a debtor has no child support arrearages, and a court enforces another nondischargeable debt, but leaves the creditor with inadequate resources to pay upcoming child support obligations.

5. <u>Require debtor to be current on family obligations before Chapter 13 plan confirmation and discharge</u>. (House and Senate.) Helpful.

6. <u>Broad definition of arrangements qualifying as child support and alimony for purposes of these provisions.</u> (House and Senate.) Helpful.

7. <u>Elevate priority of child support and alimony in bankruptcy distributions under Chapter 7</u>. Under House bill, these would be elevated from 7th priority to 3rd. Under the Senate bill, they would be 1st priority, with bankruptcy expenses (debtor attorney's fees). However, only 5% of current Chapter 7 cases have assets to liquidate (although, if state exemptions are capped, the number could increase a bit).

II. STAFF RECOMMENDATIONS ON NEEDS-BASED BANKRUPTCY -- A PROPOSAL TO RECONCILE THE CONFLICTING VIEWS

[See memorandum.]

III. TACTICAL CONCERNS – NEGOTIATE WITH THE SENATE OR WAIT FOR CONFERENCE?

POSSIBLE PROPOSALS DEALING WITH REAFFIRMATIONS

- ***Limit significantly the circumstances under which courts can approve a reaffirmation agreement.*** Currently, section 524(c) of the Bankruptcy Code imposes a host of limitations on reaffirmation agreements, including various disclosure requirements (*e.g.*, a statement in the agreement that the agreement is not required by the bankruptcy code or by nonbankruptcy law). In addition, unless the debtor's agreement to the reaffirmation is evidenced by an affidavit of the debtor's attorney, section 524(c) requires the court to analyze reaffirmation agreements and approve only those agreements that do not impose an undue hardship on the debtor or a dependent of the debtor and are in the debtor's best interests. Notwithstanding these requirements, a recent Visa survey reported that 52% of debtors surveyed reported reaffirming one or more debts, often including unsecured debts. The National Bankruptcy Review Commission recommended that the requirements of section 524(c) be amended to provide that a reaffirmation agreement be permitted, with court approval, only if the amount of the debt that the debtor seeks to reaffirm: (i) does not exceed the allowed secured claim; (ii) the lien is not avoidable under the provisions of title 11; (iii) no attorney fees, costs or expenses have been added to the principal amount of the debt to be reaffirmed; and (iv) the motion for approval of the agreement is accompanied by underlying contractual documents and all related security agreements or liens, together with evidence of the lien perfection. This proposal would eliminate reaffirmation of unsecured debt -- this would not preclude debtors from seeking to maintain unsecured credit relationships, but rather would force debtors to go to chapter 13 to work out a repayment plan.

  As an alternative to the Bankruptcy Review Commission's proposal, we could propose amendments that allow for the reaffirmation of unsecured debts but only where: (i) the reaffirmed debt, together with any other new debt incurred with respect to the same creditor, would be at an interest rate so that the payment of 2 percent of the debt per month would permit the full debt to be amortized in no more than 50 months; (ii) no attorney fees, costs or expenses have been added to the principal amount of the debt to be reaffirmed; and (iii) there is court approval (*i.e.*, unsecured debts could not be reaffirmed independently by the debtor's attorney) and the motion for approval is accompanied by all underlying documents.

- ***Penalize attempts by creditors to seek to enforce invalid reaffirmations.*** Sometimes creditors obtain debtor approval of reaffirmations, but do not meet the approval requirements of section 524(c). Often debtors make payments on such reaffirmations unaware that the agreements are unenforceable. The National Bankruptcy Review Commission recommended, and a bill by Congressman Nadler proposes, that a new section 524(k) be added to the Bankruptcy Code. This new subsection would allow an individual who has received a discharge to recover costs and attorneys fees, plus treble damages (at a minimum of $5,000), from a credit to who threatens, files suit, or otherwise seeks to collect any debt that was discharged in bankruptcy and not the subject of a reaffirmation agreement in accordance with section 524.

- ***Clarify the automatic stay to bar any threats that 707(b) motions will be filed and to bar creditors from soliciting reaffirmations of unsecured debt.*** Section 362(a)(6) of the Bankruptcy Code provides that the filing of a petition in bankruptcy operates as stay of "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title." While this provision unambiguously bars a creditors from seeking reaffirmations, some courts have ruled that creditors are free to solicit reaffirmations, as long as the solicitation does not contain "coercive" language. *See* In re Duke, 79 F.3d 43 (7th Cir. 1996). Other courts have gone so far as to allow solicitations that contain "mild warnings." *See* Brown v. Pennsylvania State Employees Credit Union, 851 F.3d 81 (3d Cir. 1988). Some of these courts might hold that letters indicating that the debtor is subject to a 707(b) motion are not violative of the automatic stay. To prevent creditors from using 707(b) motions and other devices coercively, section 362 could be modified to explicitly bar any threat by a creditor that a 707(b) motion will be filed and to bar creditors from soliciting reaffirmations of unsecured debt. Violations of this provision in the automatic stay could be punishable with liquidated damages or treble damages, plus attorney fees, similar to those discussed in the prior paragraph.

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BANKRUPTCY REFORM:
PROPOSALS POTENTIALLY AFFECTING CHILD SUPPORT AND ALIMONY

Background: The Bankruptcy Code specified rules for the treatment of a number of categories of debt. Certain debts, for example, are "priority" debts -- in a Chapter 13 repayment plan, such priority debts must be paid in full; in a Chapter 7 liquidation, payment of such claims is made in accordance with these priorities (i.e., first priority claims being paid first out of liquidations proceedings and if anything is left, then second priority claims, etc.). Other debts are classified as "nondischargeable," meaning that they survive one or more types of bankruptcy and may be pursued by creditors after the bankruptcy is completed. In some instances, particular types of debts are both nondischargeable and priority (e.g., child support); in most instances, however, the types of debts that are nondischargeable are not entitled to priority and vice-versa.

Overview: Under current law, child support and alimony obligations are afforded considerable protection under the bankruptcy laws -- the payment of such debts is prioritized in bankruptcy and such debts are nondischargeable. As originally proposed, the H.R. 3150 would have weakened these protections by adding categories of nondischargeable credit card debt that could compete for payment, both inside bankruptcy and after bankruptcy, with child support and alimony. The amendments made during the Committee mark-up of H.R. 3150 reduce somewhat the negative impact that the new credit card provisions would have on the collection of child support, but would not entirely negate the threat posed by these new forms of nondischargeable debt. Among other things, the amendments made in Committee do not appear to deal effectively with the possibility that nondischarged credit card debt would squeeze out child support obligations following bankruptcy.

Section 102 -- Payment Priority of Child Support and Alimony.

Synopsis: As indicated above, in Chapter 13, debtors are required to pay fully all priority debts. However, their chapter 13 repayment plan does not necessarily have to provide for the payment of priority debts on the same schedule. Rather, bankruptcy judges sometimes approve plans that accelerate the payment of child support obligations -- for example, arrearages might be paid in the first year of a three-year plan, while other priority debts are paid in the second and third years of the plan. As originally proposed, H.R. 3150 did not make clear whether courts could continue to accelerate the payment of child support arrearages. An amendment by Congressman Boucher would maintain the ability of bankruptcy court judges to accelerate the payment of child support arrearages in chapter 13 plans.

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Analysis:

° This provision would preserve the ability of bankruptcy judges to accelerate the payment of child support obligations.

° **Bottom Line: Does not deal with the most pressing problems created by the bill, caused by making certain credit card debt nondischargeable.**

Section 141 -- Debts Incurred to Pay Nondischargeable Debts.

Synopsis: Under current law, child support obligations have a seventh priority in bankruptcy and are nondischargeable. Various other debts, including tax debts, educational loans, damages from various tort actions (including damages from a drunk driving accident) and amounts charged on credit cards to pay federal taxes are non-dischargeable. As discussed above some of these debts have priorities (e.g., certain taxes have an eighth priority), but many receive no priority in distribution and instead are treated as general unsecured debts. Dischargeable debts that have priority over child support obligations include the administrative expenses of bankruptcy, certain wage and salary commissions, and certain unsecured claims for contributions to an employee benefit plan.

Under the original bill, a debt incurred to pay off a nondischargeable debt would itself be nondischargeable and would acquire the priority of the debt paid off. For example, if the debt paid off had a second priority under section 507 of the Code, then the debt incurred to pay off that debt would have a second priority. Under an amendment by Congressman Hyde, debts incurred to pay off a nondischargeable debt would be nondischargeable, but would have a tenth priority regardless of the priority of the debt paid off.

i.e. use credit card to pay ed loans - credit card co acquires the priority of the debt.

Analysis:

° In a Chapter 13 bankruptcy, all priority debts must be fully paid off in the repayment plan. As noted above, some non-dischargeable debts are accorded priority status; others are not and are treated as general unsecured debts for purposes of chapter 13 distributions. By establishing a tenth priority for debts incurred to pay off nondischargeable debts, the Hyde amendment would increase the amount that some debtors would have to pay off in a chapter 13 plan -- in other words, the Hyde amendments gives a tenth priority to some debts that would have been treated as general unsecured debts under the original bill. This could cause some debtors to be unable to confirm chapter 13 plans and be forced into chapter 7. It is possible that a child support obligation might be treated less favorably in a chapter 7 than in a

prob - in effect - certain debt jump ahead

est. a new priority - 10th priority child support - 7th priority

ability to bear the loss lies heavily in the non-dis/priority - wage earners, etc.

hard calls in bankruptcy

DRAFT

chapter 13 plan -- in some scenarios, for example, a child support claimant might be paid off more quickly through a chapter 13 plan than either in a chapter 7 liquidation or through a post-bankruptcy proceeding.

- In a Chapter 7 bankruptcy, the proceeds from the liquidation of non-exempt property are distributed to creditors in order of priority. Accordingly, by establishing a tenth priority for debts incurred to pay other nondischargeable debts, the Hyde amendment ensures that, in Chapter 7 distributions, child support obligations will be paid before any payments made to creditors on account of this new priority debt.

post- lives dealt in 7 somewhat: 13

- The Hyde amendment, in and of itself, would have no impact on how child support payments would be treated vis-a-vis other nondischargeable debts after bankruptcy is completed (i.e., following the completion of a chapter 7 liquidation or a chapter 13 plan.)

- **Bottom Line: Could somewhat reduce child support and alimony collections by forcing more debtors into Chapter 7, as compared to Chapter 13. Would ensure that child support and alimony debts retain their priorities in Chapter 7 distributions. Does not remedy post-bankruptcy problems created by H.R. 3150.**

Section 142 -- Credit Extensions on the Eve of Bankruptcy Presumed Nondischargeable

<u>Synopsis:</u> Under current section 523(a)(2)(A) of the Code, debts incurred by false pretenses, false representation, or actual fraud (other than a statement respecting the debtor's or an insider's financial condition) are nondischargeable. Section 523(a)(2)(C) of the Code presumes nondischargeable consumer debts owed to a single creditor and aggregating more than $1,000 for "luxury good or services" incurred by an individual debtor within 60 days before bankruptcy or cash advances more than $1,000 that are extensions of consumer credit within 60 days of the order of relief. The original bill would have made debts incurred within 90 days of the order of relief nondischargeable, whether or not incurred to purchase luxury goods or services. Under an amendment by Congressman Boucher, the presumption of nondischargeability would not apply to "consumer debts owed to a single creditor which are incurred for necessaries and aggregate $250 or less."

some case law

i. added 30 days

no longer "luxury" but all debt. assumed non-discharg...

some not swept up

meant support.

<u>Analysis:</u>

- Debts nondischargeable under section 523(a)(2) are not entitled to priority under section 507 of the Code. Accordingly, in a Chapter 13 proceeding, such nondischargeable debts would not have to be fully paid in the chapter 13 plan (however, the debtor may want to attempt to pay at least a portion of this nondischargeable debt so as to reduce his or her post-bankruptcy exposure).

tightening the rules- creates more non-dischargeable debt.

a250 !

DRAFT

- In a Chapter 7 proceeding, debts nondischargeable under section 523(a)(2) take no priority in distribution. Accordingly, child support arrearages would be satisfied before any payment was made on these 523(a)(2) debts.

- Boucher's amendment creating section 526 of the Code would provide that all child support obligations would prime any nondischargeable section 523(a)(2) debts. (See, however, notes above on section 526).

- This provision has several other flaws -- for example: (1) this provision seemingly would render nondischargeable debt consolidations that occur within 90 days of bankruptcy (such consolidations would not be for "necessaries"); and (2) this provision seemingly establishes too bright a line -- if the expenditure is $249, the presumption does not apply at all; but if the expenditure is $251, the presumption applies to the entire $251 (rather than just the amount in excess of $250).

- **Bottom Line: The credit card industry has not made the case for changing the current version of section 523(a)(2), which generally only assumes nondischargeability when amounts are expended on "luxury items." Tightening these rules could make it more likely that prospective debtors would not use their credit cards to pay for expenditures in the nature of child support (e.g, medical expenses). The modification made by the amendment does not have much effect in ameliorating this concern.**

Section 144 -- Codebtor Stay

__Synopsis__: Under the current Code, when a debtor files a petition for bankruptcy an automatic stay prevents the creditor from taking action against the debtor and his or her property. Under current law, that stay also applies to certain property not possessed by the debtor. Example, the debtor and his wife purchase a car, later divorce and then the wife received the car as part of the property settlement. The husband then files for bankruptcy. Under the current stay, the bank may not proceed against the wife and, in particular, may not proceed against the vehicle. Under the original bill, this rule would have been eliminated and the creditors could proceed against the vehicle and the wife. Under an amendment by Congressman Boucher, the co-debtor stay would, once again, apply to non-debtor spouses or ex-spouses.

jointly buying

take it back to current law

__Analysis:__

- Cures an obvious problem in the original bill.

- **Bottom Line: Deals with a problem created by the bill, but not the most pressing problems.**

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Section 145 -- Credit Extensions Without a Reasonable Expectation of Repayment Made Nondischargeable.

Synopsis:

intent not to repay nec under current law.

Under current law, courts have held that if a debtor does not intend to repay credit card charges made before filing bankruptcy, the charges are nondischargeable. Such courts require proof of specific intent -- use of a credit card foolishly, but in good faith, does not result in nondischargeability. In addition, false written statements about the debtor's financial condition are the basis for nondischargeability only if the debtor intended to deceive the creditor. Under the original bill, section 145 provided that, if the debtor used a credit card "without a reasonable expectation or ability to repay," the resulting debt would be nondischargeable. This provision would also allow a finding of nondischargeability if the debtor did not take reasonable steps to ensure that financial statements were accurate.

much more likely nondischargeability.

As amended by Congressman Watt, this provision would make nondischargeable debt incurred without a reasonable expectation or ability to repay, "unless access to such credit card or other device to a access was extended without an application therefore and reasonable evaluation of the debtor's ability to repay."

amendment to target pred. sult c

Analysis:

- Current law makes debts nondischargeable where there is proof of intentional wrongdoing. Section 145 would make debt nondischargeable if the debtor was negligent.

- By increasing the level of nondischargeable debt, this provision further exacerbates the problems that may be experienced by those attempting to collect child support and alimony following bankruptcy.

- The Watt amendment would limit this provision in a way that would discourage predatory lenders by requiring, for this provision to apply, some verification by the creditor of the debtor's ability to repay. But, overall, the Watt amendment would not so significantly limit the provision as to ameliorate its likely impact on child support and alimony collections.

- **Bottom Line: A helpful amendment, but still permits significant increases in the volume of nondischargeable credit card debt with a corresponding threat to child support and alimony collections.**

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Section 150: Protection of Child Support and Alimony Payments After the Discharge.

<u>Synopsis:</u>

under normal collection rules

Under current law, there are no rules governing the priority of nondischargeable debts once the debtor leaves bankruptcy -- the collection and payment of such debts is governed by appropriate federal and state law provisions involving such things as the priority of liens. The original bill would create various additional categories of nondischargeable credit card debt that would compete with child support obligations after bankruptcy is completed. Under an amendment by Congressman Boucher, a new section 526 of the Bankruptcy Code would be created. Under this new provision, following bankruptcy, child support obligations would generally have priority in payment and collection over a creditor's claim that was determined not to be discharged pursuant to sections 523(a)(2) (*i.e.*, debts obtained under false pretenses), 523(a)(4) (*i.e.*, debts for fraud, embezzlement or larceny); or 523(a)(14) (*i.e.*, debts incurred to pay a tax to the United States that would be nondischargeable).

Not sure it works— constitutional issue —

<u>Analysis:</u> but aim → to harass.

- This provision is designed to pick up where the Hyde amendment leaves off and purportedly would ensure that in a post-bankruptcy competition between two nondischargeable debts, child support payments would win out.

- The provision raises some constitutional concerns under the Tenth Amendment in that it would override key aspects of state collection regimes -- those concerns, however, may be manageable. More problematic, without establishing notice provisions and other types of protections, it is unclear how a court faced with a suit to enforce a nondischargeable credit card debit would know that an unpaid child support obligation exists. Even with appropriate procedural safeguards, the state court would then be in the position of having to weigh whether the payment of the credit debt affected the ability of the rehabilitated debtor to pay child support in futuro -- not exactly the type of issue courts generally consider in collection proceedings.

No assurance in that wording— no notify procedures to support that priority.

- It is unclear how this provision would work in the case of other competing post-bankruptcy debts. Example: A rehabilitated debtor has a nondischargeable credit card debt, a second debt that arises post-bankruptcy and a child support obligation. The credit card company and the second post-bankruptcy debtor both file lawsuits, obtain judgments and impose liens under state law -- the credit card company lien is filed first. The credit card company attempts to enforce its lien. Under this Boucher amendment, the child support obligation would prime the nondischargeable credit card debt, but the nondischargeable credit card debt would prime the second debt and the second debt would prime the child support obligation. Out of this mess, the court might conclude: (1) that the child support obligation stands in the shoes of the

post-bankr— helps some but not all— didn't think of it

DRAFT

nondischargeable credit card debt and thus defeats the second debt; or (2) that the second debt defeats the child support obligation.

- Finally, it should be observed that this provision is both under and overbroad. It would not apply to debts rendered nondischargeable under new section 523(a)(19) (payment of a debt that is nondischargeable), but would apply not only to other credit card debts that the bill would make nondischargeable, but also to debts currently nondischargeable under sections 523(a)(2), (4) or (14), including certain debts clearly obtained on false pretenses.

- **Bottom Line: Does not effectively prevent credit card debts from squeezing out child support and alimony in post-bankruptcy proceedings.**

b/c so many competing - debts -
deal w/ some of them

June 10, 1998

MEMORANDUM FOR HILLARY RODHAM CLINTON

FROM: NICOLE RABNER

SUBJECT: Tomorrow's Meeting on Bankruptcy Reform

The purpose of tomorrow's meeting is to engage in a discussion of the critical bankruptcy reform issues -- both substantive and political -- with which the Administration is grappling. Attached is a memorandum from the NEC that lays out these critical issues (it may overlap with the memorandum I sent earlier, and which I did not share with the NEC, but it will be more detailed, and will provide an up-to-date status report of the policy and legislative processes).

As you know, the NEC has been running the interagency policy process on this issue. Consensus has been reached on advancing to the President a proposal on means testing that would issue presumptive guidelines to the courts about determining eligibility for Chapter 7 liquidations versus Chapter 13 repayment plans. Significant tactical and substantive questions remain, however, about expanding the nondischargeability provisions of the Bankruptcy Code. It is these provisions that could endanger child support collection and that raise the questions of whether credit card debt, as a matter of principle, should be elevated to the level of obligations that today have a public priority, such as educational loans and child support. These provisions, which are in both the House and Senate bills: (1) expand (in different ways) a current provision which makes nondischargeable credit card debt amassed within 60 days before filing for luxury items above $1,000; and (2) create a new category of nondischargeable debt -- debt incurred to pay nondischargeable debt.

Today, we sent a Statement of Administration Position (SAP) to the Congress on the House bill, which is being considered on the floor of the House (attached). By a recently-added Manager's amendment, the House deleted from its bill the most egregious of its nondischargeability provisions (the provision that would make any debt, such as credit card debt, nondischargeable if a "reasonable person" could find that the debtor did not have a capacity to repay when the debt was incurred -- the Senate never included this measure in its bill). For this reason, the SAP is less strong than had been Jack Lew's original letter on the House bill.

Still unresolved are some fundamental strategic questions about where we should draw our line on the critical issues and how to engage the Congress.

June 7, 1998

MEMORANDUM FOR HILLARY RODHAM CLINTON

FROM: NICOLE RABNER

SUBJECT: Bankruptcy Reform Legislation

The purpose of this memorandum is to provide you with general information about pending bankruptcy reform legislation, and to give you a status report of the political and substantive discussions within the Administration on this issue. The House of Representatives is expected to bring its bankruptcy reform measure to the floor as early as this week (likely Wednesday); the Senate has not yet scheduled floor action on its bill.

The Administration has sent two formal communications to the Congress on bankruptcy reform -- first, a letter outlining the Administration's Consumer Bankruptcy Principles, and second, a letter expressing our strong opposition to the House bill (both attached). The NEC is overseeing an interagency policy process on this issue, and is holding meetings (one last week, one scheduled for this week) to develop consensus or sharpen disagreement on the central issues for presentation to the President. Gene is developing an overview memorandum for the President to be forwarded this week. As the bills may be moving through the Congress quickly, the President's views will determine our next communication and statement of position on these bills.

It is important to note that no one has suggested that we not engage the Congress on this issue and thereby force a veto -- rather, the debate has centered around the substance of our next communication and statement of position, what proposals to advance and where we draw our line.

You are scheduled to meet on Thursday with Gene and others; this will be an important opportunity for you to weigh in with your concerns on bankruptcy reform. Prior to that meeting, a more detailed policy memo (developed by the NEC and mirroring the memorandum being prepared for the President) will be forwarded.

PURPOSE OF REFORM / OVERVIEW OF ISSUES

Many in the Administration, particularly the economists, support strong bankruptcy reform legislation. They believe that the rise in personal bankruptcies (from roughly 300,000 per year in the early 1980s to nearly 1.7 million in 1997) is a troubling anomaly in an otherwise robust economy (see attached article). In fact, many see bankruptcy as the only economic issue on which the President and the Administration remains vulnerable, and they urge action to prevent it from becoming an election issue. Skeptics of reform in the Administration worry about sanctioning the credit card industry's practice of hawking credit to unsophisticated borrowers. It is no understatement to say that the economists in the Administration -- *e.g.*, Treasury and CEA -- feel at least as strongly in favor of reform as the skeptics are wary of it.

Proponents of strong reform argue that all consumers are hurt by the rise in bankruptcies, in the form of higher borrowing costs and less credit availability, and therefore, they maintain, all consumers will benefit if bankruptcy losses are reduced by requiring that debtors who have the ability to repay a portion of their debt do so. Moreover, they argue that is difficult for the Administration, which has made personal responsibility a core issue, not to embrace this premise. Furthermore, creditors and some academic economists maintain that the primary causes of the increase in bankruptcies are social factors, such as the reduced stigma associated with bankruptcy and the legalization of advertising by lawyers in the late 1970s.

Consumer advocates and other skeptics of reform offer a different perspective. They reject the notion that the rise in bankruptcies stems from abuse of the system. Bankruptcies result, they argue, from the abusive and predatory practices of the credit card companies to cash-strapped and unsophisticated borrowers at high rates and promoting minimum payment plans that cause debtors to carry larger and larger debt burdens. They note the strong correlation between the increase in the debt burdens born by American families and the number of bankruptcies as well as the growing severity of the debt burdens of people filing for bankruptcy to refute the suggestion that the cause of the rise in bankruptcy is abuse of the system. Moreover, even some who are sympathetic to the need for reform caution that pending proposals could adversely impact those most vulnerable, and urge strong protections, even if it means weaker reform.

SUBSTANCE OF REFORM

It may be useful to consider separately the two key areas of the pending legislation: (1) the introduction of means testing in bankruptcy reform; and (2) changes to the nondischargeability provisions of the Bankruptcy Code.

Means Testing. The purpose behind means testing provisions is to ensure that debtors who have a capacity to repay a portion of their general unsecured debt do so. These provisions would limit the number of debtors with access to Chapter 7's full and immediate discharge of debt (usually without any payments to unsecured creditors) and require them to repay a portion of their debt under a Chapter 13 repayment plan. Many in the Administration believe that means testing will crack down on abuse of Chapter 7, by targeting a small portion of higher-income filers with a capacity repay some debt and denying them access to Chapter 7 liquidations. The House and Senate bills develop means testing differently -- the House bill uses an automatic, strict formula (meaning that certain debtors are categorically denied access to Chapter 7), whereas the Senate bill provides guidance but far more discretion to the courts. Child support collection could in fact be strengthened by means testing because higher-income bankrupts will be under court supervision to pay their child support and alimony payments in a timely way.

The Administration is seeking to develop its position on means testing to advance to the

Congress. From the last meeting, the general consensus is to advance a proposal that would ensure that the bankruptcy court has significant discretion in determining a debtor's capacity to repay, but also would provide presumptive guidelines for these determinations based on factors such as the debtor's income (likely above 100 percent of National Median Income) and ability to repay a specific portion of debt (likely 30 percent). The options under consideration by the Administration to advance to the President would shift less than 10 percent of the highest-income, current Chapter 7 filers to Chapter 13. These filers have income roughly three times greater than the average Chapter 7 filer.

Another important issue under debate is the Administration's position on pending proposals to allow creditors to bring motions in determining denial of Chapter 7 relief. Under current law, creditors are not given explicit standing, and the Trustee is the only one allowed to bring a motion arguing "substantial abuse" of Chapter 7. The potential tradeoffs are clear. On one hand, allowing creditor standing provides a means to ensure appropriate means testing and therefore to accomplish the legislation's goal of requiring personal responsibility of those with an ability to repay debt (credit card companies may be in the best position to prove abuse, *e.g.*). On the other hand, it may create new opportunities for creditor abuses -- particularly coercing debtors to reaffirm debt voluntarily in order to avoid threatened litigation. The Administration is exploring options that might give creditor standing only in cases that meet the means testing presumptive guidelines and, at the same time, to advance additional proposals of protections against coercive reaffirmations.

Nondischargeability Provisions. The issue of expanding or creating new categories of nondischargeable debt in the Bankruptcy Code has been given significant attention, by consumer groups, women's groups, and, most visibly, by you in your column and the President in his radio address.

The Bankruptcy Code provides a fresh start to debtors, by discharging most of the remaining unpaid, unsecured debts after a liquidation of assets in Chapter 7 or completion of a Chapter 13 repayment plan. Thus, the Bankruptcy Code generally makes debts nondischargeable only where there is an overriding public purpose, as with debts for child support and alimony payments, educational loans, tax obligations, portions of back employee wages, or debts incurred by fraud. Credit card companies argue, however, that significant abuse exists, *i.e.* that prior to filing for bankruptcy, debtors deliberately pay nondischargeable debt with their credit cards.

Three provisions in the House bill, and two in the Senate bill, create or expand categories of nondischargeable debt. Both bills expand (in different ways) a current provision which makes nondischargeable credit card debt amassed within 60 days before filing for luxury items above $1,000, and create a new category of nondischargeable debt -- debt incurred to pay nondischargeable debt. The House bill also makes nondischargeable debt incurred at any time if "a reasonable person" would have concluded that they did not have the capacity to repay. This latter provision is particularly onerous and one that the Administration will likely oppose vigorously (it is not in the Senate version).

And while the House has taken steps to ameliorate or eliminate the impact on child support payments of these nondischargeable debts in Chapter 7 or Chapter 13, they have not adequately addressed the greatest problem -- the impact of these provisions on child support collection *post-bankruptcy*. The House did offer an amendment that says that in a post-bankruptcy competition between child support and another nondischargeable debt, the family support obligation wins out (hence, the House claims that they have "fixed" this problem). However, the Department of Justice has concluded it is not fully effective in practice -- that is, in preventing debtors from voluntarily repaying first nondischargeable credit card debt, when not under the supervision of a court of administrative agency, nor would it prevent the debtor from repaying credit card debt thus making it impossible later to meet current family support obligations.

Under significant pressure on this issue, both the House and the Senate bills offer a series of "sweeteners" to the child support community that should help in the collection of child support in bankruptcy cases (the most significant of which is to exempt child support and alimony collection from the automatic stay against all assets of the bankruptcy filer). The combination of the smaller post-bankruptcy problems with additional sweeteners makes the Senate bill a more attractive starting place on this issue, but the Administration believes additional amendments to even the Senate bill would be necessary for us to drop our opposition to the nondischargeability provisions.

As noted above, the NEC held a meeting on Friday on bankruptcy reform issues. However, while the last meeting focused nearly exclusively on the means testing provisions, a follow-up meeting is promised for early this week solely to address the nondischargeability issues. Three threshold questions should underlie that discussion: (1) is it possible to solve fully the child support collection problems; (2) how do we -- as a matter of principle -- address adding some credit card debt to the same category of debt with an overriding public purpose (*i.e.* educational loans, etc.); and (3) does making some credit card debt nondischargeable sanction credit card industry practices and thereby heighten the temptations to consumers.

MEETING ON THURSDAY

Thursday's meeting is very timely, given expected congressional action and the development of the Administration's position on the pending proposals. Gene, who is overseeing this process, supports bankruptcy reform because of the economic arguments outlined earlier, but is a cautious voice, arguing strong protections for lower-income people who could be hurt by being denied access to Chapter 7 liquidations. Maria Escheveste, a former bankruptcy lawyer, is particularly concerned about the nondischargeability provisions, raising the question of whether we should support any change or expansion in this area. The Department of Education has also raised concerns about putting credit card debt at the same level of educational loans, debt with an overriding public purpose.

Still, key players on this issue -- particularly Treasury, CEA, and somewhat less so Justice -- have weighed in heavily in favor of strong reform (*i.e.* cutting as much abuse as possible in the system and working toward a bill the President can sign). They argue that the real beneficiaries of reform are responsible consumers, who today pay for bankruptcies in the form of lower availability of credit and higher interest rates. Proponents see means testing as the first order issue and the dischargeability issue as a second order issue.

Administration Consumer Bankruptcy Principles
From letter from DoJ to Senator Hatch, dated May 7, 1998

1. Access to Chapter 7 should not be governed by an arbitrary means test; the court must have discretion to account fairly for the great variations in circumstances that bring debtors into bankruptcy (including medical expenses, unemployment, divorce, responsibility for the care of others, etc.). To promote more uniform application of bankruptcy standards, however, the determination whether a person is eligible for a Chapter 7 filing should take place within indicative or presumptive guidelines established by Congress that take into account factors such as the debtor's current and expected income and ability to repay a portion of the debt.

2. National bankruptcy policy can respect state variation in exemption levels without allowing state exemptions to be used to shield excessive assets from creditors.

3. It is appropriate to expect debtors who can afford to repay a portion of their debts (taking into account all relevant circumstances) to act responsibly; but the bankruptcy and credit reporting and granting system should reward those who complete a Chapter 13 plan.

4. Child support and alimony payments should be carefully protected. We must ensure that reforms have no unintended adverse impact on debtors' ability to meet these, and other, priority payments.

5. Bankruptcy reform should not create opportunities for creditors to coerce debtors to forgo bona fide rights in bankruptcy.

6. Bankruptcy rules should discourage bad-faith repeat filings and other attempts to abuse the privilege accorded by access to bankruptcy.

7. Bankruptcy data collection and accuracy must be improved. Analysis and understanding of the forces affecting bankruptcy filings are impeded by the lack of high-quality, nationally uniform data. Better data collection and verification procedures should be incorporated in any reform proposals. Such data can be used to assess and monitor the impact of reform legislation.

8. Scrutiny must also be given to credit industry practices that have led some borrowers to overextend themselves. While some of these issues may fall outside of the Judiciary Committee's jurisdiction, Congress and the Administration should consider proposals dealing with such issues as deceptive credit marketing and granting and enhancing disclosure of the implications of consumer credit agreements.

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

THE DIRECTOR

May 21, 1998

The Honorable George W. Gekas
U.S. House of Representatives
Washington, D.C. 20515

Dear Representative Gekas:

I am writing in response to your letter, dated May 11, 1998, to President Clinton. As the Justice Department noted in its letter to Chairman Hyde, dated May 7, 1998, the President supports bankruptcy reform that requires responsibility of debtors who have the ability to repay a portion of their debts and prevents abuse of the bankruptcy system by all relevant parties. However, the Administration strongly opposes H.R. 3150 in its present form. One provision of the bill would establish a rigid and arbitrary means test to determine whether a debtor could file for bankruptcy under Chapter 7 or would be required to file under Chapter 13 rules. Bankruptcy courts should have greater discretion to consider the specific circumstances of a debtor in bankruptcy.

H.R. 3150 also would make nondischargeable certain credit card debt. The Bankruptcy Code generally makes nondischargeable debts only where there is an overriding public purpose, as with debts for child support and alimony payments, educational loans, tax obligations, or debts incurred by fraud. There has been no sufficient finding that current protections against fraud and debt run-up prior to bankruptcy are ineffective and that the additional debts made nondischargeable by this bill rise to that level of public priority. Moreover, by making these credit card debts nondischargeable, the bill puts them in competition with payments to a former spouse or custodial parent after the debtor leaves bankruptcy, which could diminish the ability of debtors to fulfill their child support and alimony obligations. Amendments made during the Judiciary Committee mark-up are improvements but do not effectively eliminate this problem.

The Administration looks forward to working with the Congress on a balanced package of reforms that addresses these concerns and requires responsibility on the part of both debtors and creditors.

Sincerely,

Jacob J. Lew
Acting Director

IDENTICAL LETTER SENT TO THE HONORABLE BILL MCCOLLUM,
THE HONORABLE JAMES P. MORAN, THE HONORABLE RICK BOUCHER

·rsonal Bankruptcy Filings Hit Record

Easy Credit Blamed, Congress May Act

By Peter Pae and Stephanie Stoughton
Washington Post Staff Writers

A1

Despite a booming economy, the number of personal bankruptcy filings keeps escalating, hitting record numbers last year for the third consecutive year and again in the first quarter of this year.

From 1996 to 1997, filings jumped 20 percent to 1.35 million, or one in every 70 households. Maryland and Northern Virginia, two regions at the forefront of the economic boom, had some of the biggest increases in bankruptcy filings in the country, with one in every 58 households filing for ruptcy protection.

The numbers are causing concern in Congress, where the House Senate are expected to vote in the next few weeks on legislation cracking down on those seeking to wipe out their debt. Some lawmakers—backed by banks, credit card companies and retailers—say the process is too easy and that too people with the ability to repay creditors are seeking this relief.

Miguel Rodrigues is one who recently got a new lease on life when, in less than five minutes, a bankruptcy trustee wiped out $49,000 in credit card bills, or more than $2,000 in monthly pay-

See BANKRUPTCY, A6, Col. 3

BANKRUPTCY, From A1

ments, allowing Rodrigues and his family to hang on to their Germantown town house.

"It's an embarrassment to my family but I needed help," said Rodrigues, 33, an automobile repair who, despite having household income of $55,000, turned to credit cards whenever he got into a financial bind. That happened when his two children were born and when his wife crashed the family car.

"I wish I didn't have to do it [file for bankruptcy] but I couldn't make the mortgage payments because I always trying to catch up paying the credit cards," he said. "It just got

"It was something you just didn't do, something you didn't want your or your friends to about," said Rep. Bill McCollum (R-Fla.), a key supporter of bankruptcy reform legislation in the House. "But now it's no big deal. It's a way of doing business. I can't completely explain why the stigma is gone, but it's gone."

Consumer groups and economists say banks and credit card issuers are to blame. Credit is too easy to obtain and available even to those who already are financially strapped, they say, arguing that tightening bankruptcy laws would do little to stem the flood of such filings.

Filing for bankruptcy isn't painless. A record of the filing could stay on a person's credit record for up to 10 years, which would make getting a loan difficult.

"Those who want to say [that] the way to solve rising consumer bankruptcy is by changing the law are the same people who would have said during a malaria epidemic that the way to cut down on hospital admissions is to lock the door," said Elizabeth Warren, a Harvard University law school professor who studies bankruptcies.

"Bankruptcy is only the symptom, not the problem," she said. "The problem is the amount of consumer debt we've got and the way families are failing because of it."

The debate has intensified in recent years because personal bankruptcy filings are rising rapidly in the midst of a booming economy, which has been creating more jobs, increasing wages and putting more spending money in the pockets of consumers. Bankruptcy filings by businesses, in contrast, have remained relatively constant.

Among the proposals being debated in Congress is a "means test" that is intended to move some filers from a Chapter 7 bankruptcy filing to a Chapter 11 filing, which requires a repayment plan.

The measure has stirred criticism from a variety of fronts including First Lady Hillary Rodham Clinton, who said the legislation would hurt single parents who are owed child support. Such payments would have to compete with credit card debt in collections from parents who file for bankruptcy protection.

But proponents of the bill said child support payments would continue to be a priority and only after the support had been paid would credit card debt be considered for payment.

"The bills currently under consideration on Capitol Hill would in no way change the priority of those payments," a coalition of retail groups said in a statement.

Six hearings have been held in the Senate and the House. The last time the law was changed, in 1978, Con-

reform debate are people who defy stereotypes. They are mechanics, Marines and computer programmers. They are single urban residents, baby boomers with children and senior citizens. They are white, black and Asian.

"The increase has been across the board, geographically, socially and demographically," Williamson said. "There is no one set description for an individual who files for bankruptcy."

But what they increasingly have in common, bankruptcy attorneys and economists say, are huge credit card debts and a sudden downturn in their lives, such as divorce or illness. Many racked up tens of thousands of dollars on several cards, some to maintain their lifestyle while others viewed credit cards as life preservers until they could get their finances in order.

"It helped pay for groceries and clothes. It let us go on for a little longer," said a Landover medical technician who filed for Chapter 7 liquidation last month after he couldn't pay his $900 monthly mortgage. A credit card company had garnisheed $400 a month of his $1,800 monthly paycheck. He requested that his name not be used because he didn't want to jeopardize future job opportunities.

But many bankruptcy filers recently interviewed at trustee hearings in Alexandria and Greenbelt said the availability of credit wasn't their entire problem. It was the ease of using credit cards at places such as gasoline station pumps and supermarket checkout lines, which allowed these consumers to rack up debt quickly, almost without realizing it.

Though many of these filers blamed their spending habits, they also said situations in their lives that were out of their control helped cause their finances to crumble.

"We were paying off what we could, but it really got out of hand," said a 40-year-old Arlington hotel manager, who, with his 38-year-old wife, earns $45,000 a year. They had amassed $35,000 in credit card debt, mainly to pay for their college tuition and expenses for their two children.

"When we were single, it wasn't so much of a burden. But now we have two kids and all of these children's expenses," he said. "We can't catch up."

William and Sylvia Evans of Wheaton found that they couldn't afford to make the payments on more than

See BANKRUPTCY, A7, Col. 1

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The Washington Post Sunday, June 7, 1998

BANKRUPTCY, *From A6*

$12,000 in credit card debt after Sylvia was laid off as a secretary six months ago, cutting their combined income by one third. For the first few months they managed, but soon they were on the verge of being evicted from their apartment as they struggled to pay their bills.

"I had nothing to borrow against and the bills kept piling up," said William Evans, a mailman who earns about $34,000 a year. "We just couldn't work it out and that's why we're hanging on the mercy of the court."

Rockville bankruptcy attorney Jon D. Pels said consumers don't have much room to make a mistake because many incomes have not budged despite a robust economy.

"Even people in the middle and upper middle class are living paycheck to paycheck," Pels said. "When something unexpected happens that is outside their control, it makes them fall behind on payments and then it snowballs."

Ironically, an economic boom contributes to more busts as families spend more and in turn incur more debt, said Samuel J. Gerdano, executive director of the American Bankruptcy Institute.

"Like overeating causes obesity, rising consumer spending is adding to the debt burden," Gerdano said.

Lawrence E. Ausubel, an economics professor at the University of Maryland, said household debt as a percentage of disposable income has risen dramatically, to 83 percent last year from about 58 percent in 1984.

The rise in household debt was particularly dramatic shortly after the credit card industry was deregulated in the early 1980s and the ceiling on interest rates crumbled, Ausubel said. Soon, massive credit card solicitations and loosening of credit requirements followed.

Ausubel contends that the proposed changes to the laws may have an unintended effect of increasing filings. By making it harder for individuals to wipe out unsecured debt [illegible] as credit card bills in bankruptcy, [illegible] profits would rise, enticing banks to [illegible] consumer lending

Credit card officials, who have been leading the push for the changes in the law, said the industry is being used as a scapegoat. The officials contend that credit cards have helped individuals ride out financial difficulties. The changes they are seeking would weed out individuals who are abusing the bankruptcy laws to skirt paying back their debt, they say.

"What the reform effort is all about is to ensure that people get the amount of relief that they actually need, no more or no less," said William Binzel, senior vice president for MasterCard, the world's second largest credit card brand.

Meanwhile, bankruptcy filings keep rising and filers say they view this as an opportunity to start over.

Erica Harper, a 25-year-old Bowie resident, said making the bankruptcy process harder would have slammed the door on her future. Harper said she was never employed long enough to collect unemployment benefits or health insurance and as a result when she got ill recently she relied on emergency care.

She accumulated $20,000 in medical expenses, which she tried to repay by borrowing from her grandparents, one of whom died recently.

"Lots of people think filing for bankruptcy means you've got something to hide," she said. "I have nothing. I'm more worried about living."

The Washington Post
SUNDAY, JUNE 7, 1998

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THE WHITE HOUSE

WASHINGTON

June 4, 1998

MEMORANDUM TO NEC DEPUTIES

FROM: BANKRUPTCY WORKING GROUP

RE: BANKRUPTCY REFORM LEGISLATION

There will be a meeting on, Friday, June 5, at 3:00 p.m., in the Lincoln Room at the White House Conference Center, to discuss next steps on bankruptcy reform. This memorandum lays out the status of various bankruptcy issues and options for proceeding. Specifically:

- Part I frames options and recommendations for a **needs-based bankruptcy proposal** that the Administration could support.
- Part II discusses the tactical options concerning when to advance that proposal.
- Part III describes the nondischargeability provisions in the bills and DoJ staff analysis of the impact of those provisions, in general, and, in particular, on the collection of **child support and alimony**. A more detailed DoJ summary of these issues is attached.
- Part IV discusses the tactical options for commenting on these provisions.

The House of Representatives is expected to bring its bankruptcy reform measure to the floor as early as next week. OMB Acting Director Jack Lew sent a letter before the recess setting out the Administration's strong opposition to that bill. The Senate has not yet scheduled floor action on its bill.

I. NEEDS BASED BANKRUPTCY PROPOSALS

A. Background

1. The Dispute

Personal bankruptcies have risen sharply over the past fifteen years, from roughly 300,000 per year in the early 1980s to nearly 1.4 million in 1997. Despite what Goldman Sachs recently called "the best economy ever," in recent years consumer bankruptcy filings have grown at least as rapidly as before.

The creditors and some academic economists argue that the primary causes of the increase in bankruptcies are social factors, such as the reduced stigma associated with bankruptcy and the legalization of advertising by lawyers in the late 1970's. Credit card studies have financed the only studies that attempt to measure exactly how many bankrupts could afford to repay a share of their debts. Ernst & Young, for example, concluded that more than 15 percent of Chapter 7 filers could afford to pay off 20 percent or more of their unsecured, non-priority debt over 5 years. The creditors and some economists argue that all consumers bear the cost of the creditors' bankruptcy losses, in the form of higher borrowing costs and less credit availability. All consumers will benefit therefore, they argue, if bankruptcy losses are reduced by requiring that debtors, who have the ability to repay a portion of their debt, do so.

Consumer advocates offer a different perspective. High charge-offs result, they argue, from the abusive and predatory practices of the credit card companies, hawking excessive credit to cash strapped and unsophisticated borrowers at high rates and promoting minimum payment plans that cause debtors to carry larger and larger debt burdens. They note the strong correlation between the increase in the debt burdens born by American families and the number of bankruptcies as well as the growing severity of the debt burdens of people filing for bankruptcy to refute the suggestion that the cause of the rise in bankruptcy is abuse of the system.

2. *House and Senate Bill Approaches – In General*

The House and Senate each have bills that attempt to address this issue by limiting access to Chapter 7's full and immediate discharge of debt (usually without any payments to unsecured creditors) and requiring those with the capacity to repay a portion of their debt to do so under a Chapter 13 plan. However, they go about it very differently.

The House bill would limit access to Chapter 7 to those with income above 100 percent of national median family income, who could afford to repay 20 percent or more of their unsecured debts during a five-year repayment plan. Ability to repay would be measured by taking reported income and subtracting reported expenses on items such as medical care and child support, general living expenses (as determined by the IRS Collection Financial Standards for the area in which the debtor lives), and payments on secured and priority debt.

An alternative approach to needs-based bankruptcy is reflected in the Senate bill. Under current law, Section 707(b) authorizes the Court to dismiss a bankruptcy petition under Chapter 7, upon its own motion or the motion of the U.S. Trustee, if granting Chapter 7 would be a "substantial abuse." The statute provides, however, for a presumption in favor of granting the debtor's request for relief. Jurisprudence under Section 707(b) varies widely from circuit to circuit. For example, the Eighth and Ninth Circuit Courts of Appeals have held that ability to pay a significant percentage of debt out of future income is grounds for substantial abuse. The Fourth Circuit has held that a debtor's ability to repay a substantial percentage of debt, in itself, is not sufficient grounds for finding substantial abuse.

The Senate approach would modify Section 707(b) by changing "substantial abuse" to "abuse" and providing guidelines for deciding whether abuse is present. One of the factors listed as a guide is whether the debtor could repay 20 percent of unsecured, non-priority debt based on the debtor's disposable income. The Senate bill would give standing to file a 707(b) complaint to creditors, although creditors would have to pay debtors' attorney fees and costs if a filing was not substantially justified or if the party brought the motion solely for the purpose of coercing the debtor to waive a right.

There are four key differences between the two approaches.

- First, in the House approach, the door to Chapter 7 is barred for certain debtors; in the Senate approach, the door is wide open, but after entry, a court could determine that a debtor does not belong and send the debtor into Chapter 13.

- Second, to determine whether a debtor's use of Chapter 7 is appropriate, the House bill uses average living expenses for the area, as determined by the IRS for collection purposes, along with some actual expenses; the Senate uses only the debtor's actual expenses. While the IRS guidelines, on average, are higher than actual reported expenses of debtors, the average disguises a host of individual circumstances that may not be fully accounted for by the House approach.

- Third, the House bill is automatic, although there is a procedure by which the debtor can petition the court to consider extraordinary circumstances. The Senate approach vests decision making authority, and thus discretion, in the hands of the bankruptcy court.

- Finally, the House bill would extend the time for a Chapter 13 repayment plan from 3-5 years to 5-7 years and use the longer time period to assess whether the borrower has the capacity to repay a portion of their debt. The Senate bill would leave the current timetable in place and calculate whether the person has the capacity to repay over the three year period.

One similarity between the bills is that they now both would exempt from their new provisions debtors whose income is below 100% of median, although it is unclear under the Senate bill whether the existing use of Section 707(b) would be precluded for those below median income. In any event, below median income debtors would not be subject to being shifted from Chapter 7 to Chapter 13 as a result of the new tests under either the House or Senate bills.

A second similarity is that both bills would now place a cap on state homestead exemptions of $100,000. While politically difficult, the working group believes that this change is important and would have a significant impact on reducing abuse.

3. *Administration Statements Thus Far*

Critics argue that the Administration should do nothing to advance legislation promoted by those with "dirty hands." While recognizing that creditors too need to be held responsible for the problem, the Bankruptcy Working Group concluded that some reform was appropriate because: (1) all consumers suffer from the impact of rising bankruptcy rates on interest rates for consumer credit; (2) rising bankruptcy rates are a troubling anomaly and vulnerability in an otherwise healthy economy; and (3) it is appropriate and consistent with the President's central message of personal responsibility to expect those with the ability to repay a portion of their debt to do so.

The NEC Principals met in late April and decided to send Congress a set of principles that reflect the sort of responsible bankruptcy reform that the Administration could support. The working group has continued to work to craft an Administration proposal consistent with the growing severity of the debt burdens of people filing for bankruptcy those principles. The working group has now completed the analysis and reached agreement on an approach, but not all the details.

The Administration approach is based on the Senate bill's use of Section 707(b) to move from Chapter 7 to Chapter 13 debtors who have the ability to repay a portion of their debts. The Principals agreed that this approach was more appropriate because the court must have discretion to account fairly for the great variations in circumstances that bring debtors into bankruptcy. The approach allowed, however, for guidelines that would promote more uniform application of bankruptcy standards. Consistent with this approach, the working group recommends that we adopt a proposal with the following elements:

- The bankruptcy court should have discretion to determine whether or not a debtor has the ability to repay a portion of her debts. However, presumptive guidelines (based on such things as the debtor's income, ability to repay a portion of their debt, and total amount of unsecured debt owed) should be provided which will help to create greater uniformity and predictability to these determinations. These presumptions could be overcome, for example, if the court determined that the debtor could not reliably be expected to maintain his or her current level of income or that unusual but necessary expenses would be incurred. Such presumptive guidelines have proven to be highly effective in promoting uniformity and fairness in establishing child support award amounts.

- No debtor should be denied access to Chapter 7 unless she has the ability to repay at least $50/month in unsecured, non-priority debts, as in the House bill. Any lessor amount would mean that the debtor would be repaying less than $1800 over three years, an amount insufficient to merit denying her access to the fresh start.

- Debtors who move more than $50,000 from nonexempt to exempt assets within one year prior to the bankruptcy filing should be subject to scrutiny under Section 707(b), regardless of income.

- Creditors should be allowed to file motions under 707(b) seeking to move debtors from Chapter 7 to Chapter 13 in at least some cases, provided that additional limitations are placed on creditors' capacity to coerce borrowers to reaffirm debt. (The options below set out different ways of determining which debtors constitute the group that can be subjected to creditor motions. DoJ is evaluating additional proposals to limit coercive reaffirmations.)

A consensus was not reached on the other elements of the proposal for which options are presented below.

B. Income and Repayment Thresholds for Presumptions to Apply

1. ***Current Law***

Current law provides a presumption in favor of granting the debtor's request for relief under Chapter 7. It limits access to Chapter 7 if courts find that such a filing is "substantial abuse" under Section 707(b). Roughly 1.4% of cases were affected by imposition of this Section.

For considering repayment in Chapter 13, and (in some districts) for considering whether there is substantial abuse of Chapter 7, the courts refer to Section 1325, which defines disposable income as that income not reasonably necessary for the support of the debtor or dependents. Other courts have considered the "totality of the circumstances" of the debtor.

2. ***Current House and Senate Bills***

The House bill would deny access to Chapter 7 to those with income above 100% of national median income for a family of equal size, who could afford to repay 20% or more of their unsecured debts during a five-year repayment plan, and who can pay at least $50/month. The courts would also be empowered to allow debtors access to Chapter 7, despite this test, under "extraordinary circumstances".

The Senate bill requires courts to consider, in determining whether abuse is present under Section 707(b), whether the debtor could pay 20% or more of unsecured nonpriority debt, as well as whether the filing was made in good faith or the debtor made attempts to work out the debt before filing.

3. ***Options***

The impact of alternative presumptive guidelines reflects a tradeoff between shifting too few debtors (and therefore leaving in Chapter 7 many individuals who can repay their debts) and shifting too many (and therefore increasing the number of Chapter 13 failures and denying the "fresh start" to those who truly warrant it). Evaluating the tradeoff requires information on the debtors that could be shifted across chapters by different guidelines. The Appendix provides data on the impacts of various combinations of guidelines. (Note, however, that the data in the Appendix, as well as the analysis provided below, is based on the assumption that the period of repayment will be stretched from three to five years, since that is how Ernst & Young calculated its analysis of the House bill. Additional analysis based on a three year repayment period has been requested but probably will not be provided before Friday's meeting. One can assume that the number of debtors shifted, if a three year period is used, would be fewer than those noted, but that the relative impact of the various proposals would not be changed.)

The test that will cause the presumption to be invoked can have three elements: some income threshold, some percentage of unsecured debt that the debtor could repay from repay from disposable income; and perhaps some level of unsecured debt outstanding. Many possible combinations could be developed, but we illustrate four options below.

Selecting a lower income threshold best accomplishes a goal of protecting those thought most likely to have unpredictable earning capacity and greater hardship. The threshold of the percentage of unsecured debt that can be repaid measures the difference between what the debtor owes and what the debtor earns. Thus, the higher the percentage, the greater the likelihood that the borrower will succeed under the repayment plan. Moreover, that test focuses on asking personal responsibility of those thought to have the capacity to repay a portion of their debt, regardless of income, thus avoiding class based classifications. Finally, the test involving a minimum level of unsecured, nonpriority debt, is one way to protect those who a creditor might seek to shift from Chapter 7 to Chapter 13, not because the debt owed was sufficient to justify the effort, but to coerce them to forego another right.

In considering these options, one should remember that the goal of these presumptions are to, on the one hand, shift from Chapter 7 to Chapter 13, those who genuinely have the capacity to repay a portion of their debt and thus will be successful in completing a Chapter 13 repayment plan, while, on the other hand, not inappropriately denying access to Chapter 7 discharge to those who truly need the fresh start. Shifting too many could cause more Chapter 13 failures or drive folks from the bankruptcy system into the underground economy. Alternatively, shifting too few does nothing to address the mounting cost of debt chargeoffs to all consumers, in the form of higher credit costs, and the need for personal responsibility.

a. *Gross Income of 100% of National Median; 20% Ability to Repay*

pre- ut wondering over

Note: This approach would apply to between 11 and 14% of Chapter 7 filers, depending on the definition of disposable income used (the lower figure referring to a House bill-type formula, and the higher to actual reported expenses; the House bill formula is more generous on average). The actual number of cases shifted will be smaller, since 707(b) motions will not be filed in all eligible cases.

11–11% Current repayment

b. *Gross Income of 100% of National Median; 20% Ability to Repay; At Least $1800 in unsecured non-priority debt.*

Note: Adding the $1800 minimum debt level criterion has a trivial impact on the number

Average payment - 20

of debtors' shifted.

c. *Gross Income of 100% of National Median; 40% Ability to Repay*

Note: This would apply to 9-10% of Chapter 7 cases; once again, this is an upper bound on the number of cases that would actually be impacted. 6.5-7.5%

d. *Gross Income of 110/125% of National Median; 20% Ability to Repay*

Note: A criterion of 110% of national median income would affect 10-12 percent of Chapter 7 cases; a criterion of 125% of national median income would affect 7-9 percent of cases. Once again, this is an upper bound on the number of cases that would actually be impacted. 8.5-9.5%

C. Creditor Motions (Income and/or Repayment Thresholds for Creditor Motions)

1. ***Current Law***

Under current law, creditors are not given explicit standing in determining denial of Chapter 7 relief; the Trustee is the only one allowed to bring a motion for denial for "substantial abuse."

2. ***Current House and Senate Bills***

The Senate bill allows creditors to bring motions under 707(b), with fee shifting provisions that would provide that a creditor would have to pay the debtor's attorney's fees and costs if the motion was not substantially justified. If the Trustee brought the motion and prevailed, the debtor's lawyer would have to reimburse the Trustee for costs and attorney's fees. However, there is no provision making the debtor or its attorney potentially liable for creditor legal fees.

3. ***Options***

The potential tradeoffs from allowing creditor standing are clear. On the one hand, allowing creditor standing provides a means to ensure appropriate use of Section 707(b) to accomplish the legislation's goal of requiring personal responsibility of those with the ability to repay, regardless of whether or not trustees take the time to scrutinize closely for abuse and use the mechanism. On the other hand, it may create new opportunities for creditor abuses -- particularly coercing debtors to reaffirm debt. DoJ and Treasury staff note, however, that the types of threats to which a consumer could be subject will be unlikely to differ depending upon whether or not the law gives a creditor the right to file a motion under Section 707(b). (Imagine a letter to a debtor that reads: "We believe that you have the capacity to repay. Under the bankruptcy code, it is abuse for a person with the ability to repay a portion of their debts to seek relief under Chapter 7. We will pursue our rights fully.")

One possibility is to allow creditor motions (see below), but provide additional protections against coercive reaffirmations. Under current law, reaffirmations must be filed with the court, the debtor must be fully advised of the consequences, and the agreement must not cause undue hardship. After a highly publicized case of creditor abuse in the Sears case, courts are scrutinizing reaffirmations more closely. Creditors that attempt to collect from debtors on invalid reaffirmation agreements or otherwise threaten or coerce debtors, do face penalties. **DoJ is reviewing options for additional protections against coercive reaffirmations.** (For example, the Bankruptcy Commission has proposed that a creditor attempting to collect from debtors illegally be penalized costs and fees plus treble damages.)

a. *Creditor Standing for all cases*

b. *Creditor Standing Only for Cases that Meet Presumptive Guidelines*

c. *Allow Creditor Standing Only at a Higher Threshold than Presumption; e.g. if Presumption is at 100% of Median Income, Allow Standing only at 125% of Median; or if Presumption is at Ability to Repay 20% of Debt, Allow Standing only at 40%.*

d. *Allow No Creditor Standing*

D. Definition of Discretionary Income

1. ***Current Law***

Under current law, in developing a repayment under Chapter 13, and (in some districts) for considering whether there is substantial abuse under Section 707(b), the courts refer to Section 1325, which defines disposable income as that income not reasonably necessary for the support of the debtor or its dependents. Other courts consider the "totality of the circumstances" of the debtor.

2. ***Current House and Senate Bills***

The House bill jettisons the current Bankruptcy Code concept of disposable income. In its place, the bill adopts a formulaic approach to calculating the ability to repay, which is defined by subtracting expenses and payments on secured and priority debt from reported income. Expenses include debtor-reported expenses such as medical care, child support, and (with some limits) home mortgage expenses; and, for other items such as food and transportation expenses, general living expenses as determined by the IRS Collection Financial Standards for the area in which the debtor lives. (The IRS standards are derived directly from Bureau of Labor Statistics consumer expenditure survey data.) The courts would also be empowered to allow debtors access to Chapter 7, despite this test, under "extraordinary circumstances".

In the Senate bill, ability to repay is determined using the current law definition of disposable income: debtor-reported income minus expenses.

3. ***Options***

A major limitation in applying presumptive guidelines is the almost unlimited flexibility present in the current Section 1325. While disposable income in some districts has been defined relative to a reasonable standard of living, in other districts debtors have been able to maintain their very generous pre-bankruptcy lifestyle. Moreover, courts in some districts have approved repayment plans that included payment for luxury items like expensive cars and boats, while courts in other districts have not. Allowing this flexibility to continue would undercut the purposes of presumptive guidelines, since, with very generous definitions of disposable income, it will be difficult to find debtors who can repay 20% (or more) of their unsecured, non-priority debt. Reform in this area would, to some extent, standardize the definition of disposable income to make presumptive guidelines fairer and more uniformly effective nationwide.

In considering these options, one should consider that incorporating an explicit disallowance for luxury goods or services would adopt a test for which there is a large body of jurisprudence, not entirely uniform, but one with which the courts are familiar and comfortable. Using instead a test that allows expenses consistent with a reasonable standard of living for the area can still leave it to the judge to determine what is reasonable, creating more guidance but leaving the court with significant discretion. Using formulas, whether as explicit guidelines or factors to consider, has the benefits and disadvantages of providing greater uniformity. On the one hand, it prevents the outlandish lifestyle from excusing debt repayment while allowing one to take into consideration the difference between life in Los Angeles and life in Des Moines. On the other hand, it would not recognize all the cost of living implications of some relatively fixed decisions, like the neighborhood in which one lived, and thus has the same problem you have applying any average standard to individual circumstances.

X a. *Existing Definition, but with Explicit Disallowance for Luxury Goods or Services*

b. *Define disposable income as income minus reasonable necessary expenses, as today, but with expenses consistent with a reasonable standard of living in the area in which the debtor lives; could augment this with explicit factors to consider and sources of data to use (e.g. BLS cost of living statistics).*

c. *Provide Explicit Guidance to the Courts via Formula (e.g. Gekas or some other formulation)*

E. <u>707(b) Terminology -- "Abuse" or "Inappropriate Use"</u>

1. ***Current Law***

Section 707(b) today is a mechanism for removing debtors from Chapter 7 upon a finding of "substantial abuse."

2. *Current House and Senate Bills*

The Senate bill would change the test from "substantial abuse" to "abuse." The House bill would change the test from "substantial abuse" to "inappropriate use."

3. *Options*

The term used is less important than the test used. As a result, some think the choice of words is probably not an issue that the Administration should invest in changing. On the other hand, going from "abuse" in the Senate bill to "inappropriate use" would be one way to find compromise between the House and Senate approaches.

a. *"Abuse."*

b. *"Inappropriate use."*

II. TACTICAL CONSIDERATIONS IN ADVANCING AN ADMINISTRATION NEEDS-BASED BANKRUTPCY PROPOSAL

We may want to achieve at least two goals before the bills go into conference. First, we may want to have sufficient credibility with Republican proponents to be taken seriously in conference. If they suspect we are simply trying to sabotage any bill, we will have less likelihood of influencing the outcome and face a greater chance that the President will be presented with a bill that he will have to veto. Second, we want to place some pressure to the left of the Senate bill, to prevent objectionable backsliding toward the House approach during conference negotiations between the two bodies.

With those and other goals in mind, the central tactical decision is whether the Administration should advance none, some, or all of its proposals on needs-based bankruptcy before Senate Floor action or whether we should wait until Conference. On the one hand, some of our proposals (use of presumptive guidelines, for example) may be seen as bridging a gap between the more moderate Senate bill and the more conservative House bill. Other provisions, however, (such as further limitations on who could be moved from Chapter 7 to Chapter 13, who could be subject to a motion by a creditor, and additional prohibitions on coercive reaffirmations) are clearly to the left of the Senate bill.

III. NONDISCHARGEABILTY PROVISIONS

The Bankruptcy Code provides a fresh start to debtors, by discharging most of their remaining unpaid, unsecured debts after a liquidation of assets in Chapter 7 or completion of a Chapter 13 plan. Thus, the Bankruptcy Code generally makes debts nondischargeable only where there is an overriding public purpose, as with debts for child support and alimony payments, educational loans, tax obligations, portions of back employee wages, or debts incurred by fraud. Debts typically obtain that special status for one of two interrelated reasons: either (1) there is an overriding policy argument against discharging the debt itself (e.g., debt incurred by fraud) or (2) there is a policy imperative to protect the creditor of that debt (e.g., a portion of the back wages owed to employees or child support or alimony).

Three provisions in the House bill (and two in the Senate bill) create or expand categories of nondischargeable debt. In each case, we must ask two questions: (1) do the additional debts made nondischargeable by this bill rise to a level of public priority akin to other nondischargeable debt; and (2) what impact does the protection of these new categories of debt have on the ability of the debtor to repay other categories on nondischargeable debt, in particular child support and alimony.

In general terms, the House bill creates significantly larger new or expanded categories of nondischargeable debts than does the Senate bill. The House has taken steps to ameliorate or eliminate the impact on child support payments of these nondischargeable debts in Chapter 7 or Chapter 13, but has not adequately addressed the greatest problem -- the impact that these provisions will have on the payment of child support post-bankruptcy. They did offer an amendment that says that in a post-bankruptcy competition between child support and another nondischargeable debt, the family support obligation wins out. However, DoJ staff have concluded it is not fully effective in preventing debtors from voluntarily repaying first nondischargeable credit card debt, when not under the supervision of a court or administrative agency nor would it prevent the debtor from repaying credit card debt thus making it impossible later to meet current family support obligations..

The Senate bill further reduces the categories of nondischargeable debt to one, in cases where there are child support obligations outstanding.

Both bills offers a series of "sweeteners" to the child support community that should help in the collection of child support in bankruptcy cases (e.g., relief from the automatic stay for child support collection against all assets of the debtor). The Senate bill has one additional provision which gives a first priority to child support and alimony payments, which would allow for some additional payments of arrearages in the five percent of Chapter 7 cases in which there are assets to distribute. The combination of the smaller post-bankruptcy problem with the additional sweetener makes the Senate bill a far more attractive starting place. However, additional amendments to the Senate bill would be necessary for us to drop our opposition to the nondischargeability provisions. **Attached is a Department of Justice prepared document that analyzes the current provisions and their impact on family support obligations.**

IV. TACTICAL CONSIDERATIONS IN COMMENTING ON NONDISCHARGEABILITY PROVISIONS

On the one hand, the Hill and the women's groups are eager for us to provide a detailed analysis of the bill's impact on family support obligations. However, there is some danger that we will conclude problems are fixed that they feel are not and we could find ourselves criticized from that perspective, where we want to be supportive. In addition, thought should be given to whether by providing the Congress with a road map to addressing our concerns, we reduce our leverage and ability to influence the bill in conference.

Administration Consumer Bankruptcy Principles
From letter from DoJ to Senator Hatch, dated May 7, 1998

1. Access to Chapter 7 should not be governed by an arbitrary means test; the court must have discretion to account fairly for the great variations in circumstances that bring debtors into bankruptcy (including medical expenses, unemployment, divorce, responsibility for the care of others, etc.). To promote more uniform application of bankruptcy standards, however, the determination whether a person is eligible for a Chapter 7 filing should take place within indicative or presumptive guidelines established by Congress that take into account factors such as the debtor's current and expected income and ability to repay a portion of the debt.

2. National bankruptcy policy can respect state variation in exemption levels without allowing state exemptions to be used to shield excessive assets from creditors.

3. It is appropriate to expect debtors who can afford to repay a portion of their debts (taking into account all relevant circumstances) to act responsibly; but the bankruptcy and credit reporting and granting system should reward those who complete a Chapter 13 plan.

4. Child support and alimony payments should be carefully protected. We must ensure that reforms have no unintended adverse impact on debtors' ability to meet these, and other, priority payments.

5. Bankruptcy reform should not create opportunities for creditors to coerce debtors to forgo bona fide rights in bankruptcy.

6. Bankruptcy rules should discourage bad-faith repeat filings and other attempts to abuse the privilege accorded by access to bankruptcy.

7. Bankruptcy data collection and accuracy must be improved. Analysis and understanding of the forces affecting bankruptcy filings are impeded by the lack of high-quality, nationally uniform data. Better data collection and verification procedures should be incorporated in any reform proposals. Such data can be used to assess and monitor the impact of reform legislation.

8. Scrutiny must also be given to credit industry practices that have led some borrowers to overextend themselves. While some of these issues may fall outside of the Judiciary Committee's jurisdiction, Congress and the Administration should consider proposals dealing with such issues as deceptive credit marketing and granting and enhancing disclosure of the implications of consumer credit agreements.

APPENDIX

Evaluating the impact of alternative guidelines

Tables 1 and 2 present the share of Chapter 7 filers that would be affected over a range of alternative guidelines. These tables summarize data that was provided to Treasury by Ernst & Young, from a nationally representative database of Chapter 7 filers.

Table 1 shows the impact of applying a Gekas-type needs based formula, at different cutoffs in terms of gross household income and ability to repay unsecured, non-priority debts. Table 2 shows this same analysis, but using the debtors own reported expenses. Defining disposable income using the debtor's own reasonably necessary expenses increases the numbers of filers who meet the conditions, since of median expenses for the area in which the debtor lives overstates the actual living expenses reported by most of the Chapter 7 debtors.

Table 1. Percent of Chapter 7 Filers Impacted by Gekas-type Needs Based Provisions

Gross Income as a % of National Median	Filers with Monthly Net Income > $50 and Share of Unsecured Nonpriority Debt Repayable		
	> 20%	> 40%	> 50%
> 100%	11.2	9.4	7.9
> 110%	9.6	8.2	6.9
> 125%	7.3	6.2	5.2

Source: Calculations from data by Ernst & Young using 1997 VISA national bankruptcy database, expenses as allowed under HR 3150

Table 2. Percent of Chapter 7 Filers Impacted by Discretionary Needs Based Provisions

Gross Income as a % of National Median	Filers with Monthly Net Income > $50 and Share of Unsecured Nonpriority Debt Repayable		
	> 20%	> 40%	> 50%
> 100%	14.1	10.3	9.2
> 110%	11.9	8.8	7.8
> 125%	8.8	6.5	5.7

Source: Calculations from data by Ernst & Young using 1997 VISA national bankruptcy database, expenses based on statements in bankruptcy petitions

Note: Assumes repayment over 5 years, as per Gekas bill, not 3 years, as per current law.

Prepared by the Department of Justice

. **Proposals Potentially Affecting Child Support and Alimony**

Background. The Bankruptcy Code specifies rules for the treatment of a number of categories of debt. Certain debts, for example, are "priority" debts – in a Chapter 13 repayment plan, such priority debts must be paid in full; in a Chapter 7 liquidation, payment of such claims is made in accordance with these priorities (*i.e.*, first priority claims are paid first out of liquidating proceeds and, if anything is left, then second priority claims, etc.). Other debts are classified as "nondischargeable," meaning that they survive one or more types of bankruptcies and may be pursued by creditors after the bankruptcy is completed. In some instances, categories of debt are both nondischargeable and priority; in most instances, however, the types of debts that are nondischargeable are not entitled to priority and vice-versa. Child support and alimony obligations have a seventh priority in bankruptcy and are nondischargeable.

Because child support and alimony obligations are both priority and nondischargeable debts, the creation of other forms of priority and nondischargeable debt (e.g., credit card debt) could make it more difficult to collect child support and alimony obligations both during and after a bankruptcy proceeding. If other priority debts are created, the effect within bankruptcy is to make it less likely that a debtor will successfully confirm or complete a chapter 13 repayment plan – among other things, such repayment plans are beneficial to child support and alimony collections as debtors are required, under such plans, to pay off arrearages and maintain currency on payments owed. If other nondischargeable debts are created, the effect, after bankruptcy, is to provide more competition for collection of owed debts out of property and income surviving the bankruptcy, with the prospect that institutional creditors will squeeze out child support and alimony recipients.

The House Bill.

<u>Nondischargeability provisions</u>. The House Bill has three provisions that would expand the categories of priority and nondischargeable credit card debt:

> *Section 141.* As originally introduced, section 141 of the bill would have provided that a debt incurred to pay off a nondischargeable debt would itself be nondischargeable and would be assigned the same priority as the nondischargeable debt paid off (e.g., if a debtor used a credit card to pay a second priority wage claim, the credit card debt would be nondischargeable and would assume a second priority). In the Judiciary Committee, this provision was modified – while debts incurred to pay off a nondischargeable debt would still be nondischargeable, they would be afforded only a tenth priority.
>
> *Section 142* Current bankruptcy law generally makes nondischargeable consumer debts owed a single creditor and aggregating more than $1,000 for "luxury goods or services" incurred by an individual debtor within 60 days before bankruptcy. As originally introduced, section 142 would have amended current bankruptcy law to make all consumer debts incurred within 90 days of bankruptcy presumptively nondischargeable. In the Judiciary Committee, this provision was modified so that

the presumption of nondischargeablility would not apply to "consumer debts owed to a single creditor which are incurred for necessaries and aggregate $250 or less."

Section 145. Under current law, debts incurred with a specific intent not to repay are deemed fraudulent and are nondischargeable. As originally introduced, section 145 would have modified this law and made nondischargeable consumer debts incurred "without a reasonable expectation or ability to repay." As amended by the Judiciary Committee, this provision would make debt incurred without a reasonable expectation or ability to repay nondischargeable, "unless access to such credit card or other device to a access was extended without an application therefore and reasonable evaluation of the debtor's ability to repay."

· Child Support and Alimony Collection Measures. The House Bill has several provisions designed to improve the collection of child support and alimony:

Section 102. In Chapter 13, current law requires debtors to pay fully all priority debts, including child support arrearages. However, their chapter 13 repayment plans do not necessarily have to provide for the payment of priority debts on the same schedules and judges sometimes approve plans that pay child support arrearages before other types of priority debts. As originally proposed, the House Bill did not make clear whether courts could continue to accelerate the payment of child support arrearages. As amended by the Judiciary Committee, the bill would maintain the ability of bankruptcy judges to order such accelerations.

Section 146. Section 146 of the bill would enhance child support and alimony collections in two fashions. First, it would except from the automatic stay (*i.e.*, a stay on creditor activities that automatically arises as of the filing of a bankruptcy petition), certain governmental actions to collect child support, such as garnishment orders authorized by the Social Security Act. Second, it would clarify that child support and alimony obligations surviving bankruptcy would be collectable from property retained by the debtor following bankruptcy that is otherwise exempt from post-bankruptcy collection activity.

Section 150. Under current law, there are no rules governing the priority of nondischargeable debts once the debtor leaves the bankruptcy -- the collection and payment of such debts is governed by appropriate federal and state law provisions. The bill, as amended by the House Judiciary Committee, contains a new provision under which, following bankruptcy, child support and alimony obligations would generally have priority in payment and collection over a creditor's claim that was determined not to be discharged pursuant to various bankruptcy sections, including the sections described above creating new forms of nondischargeable credit card debt.

In addition, the House bill clarifies existing law in: (i) requiring a debtor to be current on all child support and alimony payments before being allowed to confirm a plan and obtain a discharge of debts under Chapter 13; and (ii) defining broadly the types of arrangements and agreements qualifying as child support and alimony for purposes of the bankruptcy provisions designed to facilitate the collection of such obligations.

The Senate Bill.

<u>Nondischargeability Provisions</u>. The Senate bill has only two provisions that would expand the categories of nondischargeable credit card debt:

> ***Section 316.*** As originally introduced, section 316 of the Senate bill, like section 141 of the House bill, would have provided that a debt incurred to pay off a nondischargeable debt would itself be nondischargeable. Unlike the House bill, Section 316 did not assign these new nondischargeable debts any priority. Further, in the Judiciary Committee, this provision was modified to include an exception for debtors who are single parents or owe child support or alimony. Under the exception, debts incurred by such debtors to pay a nondischargeable debt would be nondischargeable only if the creditor could demonstrate that "the debtor intentionally incurred the debt to pay the nondischargeable debt."
>
> ***Section 317.*** As originally introduced, section 317 of the Senate bill was essentially the same as Section 142 of the House bill and would have rendered presumptively nondischargeable debts incurred within 90 days of bankruptcy. As amended by the Judiciary Committee, section 317 would except from this presumption debts less than $400 incurred for "goods or services reasonably necessary for the maintenance or support of the debtor or a dependent child of the debtor."

Notably, the Senate bill does not have a provision like section 145 of the House bill, that would make nondischargeable consumer debt incurred "without a reasonable expectation or ability to repay."

<u>Child Support and Alimony Collection Measures.</u> As amended by the Judiciary Committee, the Senate bill contains several of the child support and alimony collection measures contained in the House bill: (i) like section 102 of the House bill, section 324 of the bill prefers payment of child support in chapter 13 proceedings; (ii) like section 146 of the House bill, section 326 of the Senate bill excepts from the automatic stay certain governmental actions to collect child support and alimony; (iii) like section 146 of the House bill, section 328 of the Senate bill would make property retained by the debtor following bankruptcy subject to child support and alimony debts; and (iv) like various sections in the House bill, various sections of the Senate bill would require a debtor to be current on all child support and alimony payments before being allowed to confirm a plan and obtain a discharge of debts under Chapter 13 and would define broadly the types of arrangements and agreements qualifying as child support and alimony.

As noted above, the Senate bill does not contain a provision like section 150 of the House bill, that would prioritize, in post-bankruptcy collection proceedings, the payment of nondischargeable child support obligations over other nondischargeable credit card debts. The Senate bill, however, does contain a provision that would elevate child support and alimony obligations from seventh priority to first priority in bankruptcy distributions. Under this provision, in a Chapter 7 liquidation, distributions of liquidation proceeds would be made to child support and alimony creditors at the same time that expenses of the bankruptcy (the debtor's attorneys fees) are paid.

Analysis

In analyzing these provisions in terms of their impact on child support and alimony, it is best to focus on two questions: (i) what impact will the nondischargeability provisions have in creating nondischargeable debt that will compete with child support and alimony obligations; and (ii) what impact will the other provisions in the bills that facilitate the collection of child support and alimony have in ameliorating the nondischargeability provisions.

Nondischargeability provisions. While increasing the amount of nondischargeable credit card debt undoubtedly would have some negative impact on child support and alimony collection, there are no statistics that allow us to estimate the actual impact of the provisions in these bills. Relatively speaking, however, the provisions in the House bill that would afford nondischargeability to new classes of credit card debt are clearly and significantly broader than the nondischargeability provisions in the Senate bill. Indeed, for cases implicating child support and alimony, the Senate bill essentially lacks two of three offending nondischargeability provisions in the House bill.

Thus, the Senate bill does not contain a provision like section 145 of the House bill, that would make nondischargeable consumer debts incurred without a reasonable prospect of repayment. This is a significant omission, as Section 145 likely would have, by far, the broadest impact of any of these nondischargeability provisions — it essentially would replace the current rules, which make "fraudulently" incurred debts nondischargeable, with a rule that would make "unreasonably" incurred debts nondischargeable. Further, in the case of a debtor owing child support or in the case of a single parent, the Senate bill would limit the nondischargeability of debts incurred to pay other nondischargeable debts to those situations where a creditor could prove that the debtor paid the nondischargeable debts knowing the bankruptcy ramifications. This actual knowledge requirement, which was added by the Senate Judiciary Committee, would mean that this provision rarely would apply in situations where the debtor owed a child support obligation. Finally, even the one provision the Senate bill shares with the House bill, which would make nondischargeable certain debts incurred within 90 days of bankruptcy, has a greater safe harbor for consumers than the Hose bill, allowing debtors to discharge up to $400 (as compared to $250) in necessary expenditures incurred with respect to a single creditor. (Indications are that the $400 figure may be increased to $750 before floor action on the Senate bill.)

Accordingly, the House provisions clearly would result in a greater volume of credit card debt being declared nondischargeable than the Senate provisions. The House bill thus poses a considerably greater risk of credit card debts competing with and potentially priming child support and alimony obligations.

<u>Child Support and Alimony Collection Measures.</u> The House and the Senate bills both contain several provisions designed to improve child support and alimony collections. We are in no position to evaluate whether, in terms of raw dollars, these measures would increase child support and alimony collection more than the nondischargeability provisions in the bill would effectively decrease such collections. However, in general, it appears that the Senate provisions would have a more curative impact – not because they afford more collection potential than their House counterparts, but because the scope of the nondischargeability problem created by the Senate bill is significantly smaller to begin with and thus requires less of a solution.[1]

Of the provisions shared by the House and Senate bills, the provision excepting certain child support collection actions from the automatic stay is likely to have the greatest impact. In effect, this provision allows governmental units collecting child support to proceed while the automatic stay stops all other creditors in their tracks. Free from the automatic stay, these governmental may establish garnishment orders and liens that could lead to the full payment of arrearages while the debtors other obligations are being sorted out by the bankruptcy court. And if these garnishments and liens do not work, the governmental units and the individuals owed child support may still pursue the wide range of bankruptcy remedies for child support and alimony in existing law and as further expanded by these bills.

The Senate and House child support and alimony collection measures differ in two major regards:

> ***Prioritization of child support and alimony.*** Unlike the House bill, the Senate bill gives a first priority to child support and alimony obligations. In Chapter 7 cases in which there are distributions to unsecured creditors, this provision would likely lead

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[1] Moreover, unlike the Senate bill, the House bill creates a second problem by affording certain nondischargeable credit card debts a tenth priority. This has the effect of increasing the potential amount of priority debt owed by a debtor and thereby decreasing the likelihood that a debtor will be able to confirm or complete a chapter 13 repayment plan (under which the debtor is required to pay all priority debts in full). As noted above, child support and alimony obligations tend to be treated favorably in chapter 13 plans. Accordingly, by making the confirmation of such plans more difficult, the provision in the House bill that would prioritize certain credit debts creates an additional collection problem for child support and alimony.

to some additional payments of child support and alimony beyond what would be required by current law. However, it should be noted that such liquidating distributions occur in only about 5 percent of Chapter 7 cases -- thus, this new priority provision would have no impact in approximately 95 percent of Chapter 7 cases.

Post-bankruptcy priority rule. Unlike the Senate bill, the House bill has a provision, section 150, that provides that in a post-bankruptcy competition between two nondischargeable debts, child support and alimony payments would win out. While, at first blush, this provision seemingly would give a big boost to child support and alimony collections, in fact, it has at least two major limitations. First, it would have virtually no impact in cases where credit card debt collection would occur informally, without resort to a court or administrative agencies. In such circumstances, there would be no entity to enforce the priority created by section 150 and the debtor could, for example, send a check to a credit card company and thereby frustrate the collection of child support. Second, this provision would have no impact in cases where the payment on the nondischargeability credit card debt occurred at a time in which the rehabilitated debtor was not in arrears on child support or alimony, but, as a result of the payment, later was left with inadequate resources to discharge his current child support or alimony allegations. Given these limitations, section 150 does not appear to go nearly far enough in addressing the significant problems associated with the nondischargeability provisions in the House bill.

- *Clarify the automatic stay to bar any threats that 707(b) motions will be filed and to bar creditors from soliciting reaffirmations of unsecured debt.* Section 362(a)(6) of the Bankruptcy Code provides that the filing of a petition in bankruptcy operates as stay of "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title." While this provision unambiguously bars a creditors from seeking reaffirmations, some courts have ruled that creditors are free to solicit reaffirmations, as long as the solicitation does not contain "coercive" language. *See* In re Duke, 79 F.3d 43 (7th Cir. 1996). Other courts have gone so far as to allow solicitations that contain "mild warnings." *See* Brown v. Pennsylvania State Employees Credit Union, 851 F.3d 81 (3d Cir. 1988). Some of these courts might hold that letters indicating that the debtor is subject to a 707(b) motion are not violative of the automatic stay. To prevent creditors from using 707(b) motions and other devices coercively, section 362 could be modified to explicitly bar any threat by a creditor that a 707(b) motion will be filed and to bar creditors from soliciting reaffirmations of unsecured debt.

- *Limit further the circumstances under which courts can approve a reaffirmation agreement.* Currently, section 524(c) of the Bankruptcy Code imposes a host of limitations on reaffirmation agreements, including various disclosure requirements. In addition, unless the debtor's agreement to the reaffirmation is evidenced by an affidavit of the debtor's attorney, section 524(c) requires the court to analyze reaffirmation agreements and approve only those agreements in the debtors best interests. Notwithstanding these requirements, a recent Visa survey reported that 52% of debtors surveyed reported reaffirming one or more debts, often including unsecured debts. The National Bankruptcy Review Commission recommended that the requirements of section 524(c) be amended to provide that a reaffirmation agreement is permitted, with court approval, only if the amount of the debt that the debtor seeks to reaffirm: (i) does not exceed the allowed secured claim; (ii) the lien is not avoidable under the provisions of title 11; (iii) no attorney fees, costs or expenses have been added to the principal amount of the debt to be reaffirmed; and (iv) the motion for approval of the agreement is accompanied by underlying contractual documents and all related security agreements or liens, together with evidence of the lien perfection. This proposal would eliminate reaffirmation of unsecured debt -- this would not preclude debtors from seeking to maintain unsecured credit relationships, but rather would force debtors to go to chapter 13 to work out a repayment plan.

- *Penalize attempts by creditors to seek to enforce invalid reaffirmations.* Sometimes creditors obtain debtor approval of reaffirmations, but do not meet the approval requirements of section 524(c). Often debtors make payments on such reaffirmations unaware that the agreements are unenforceable. The National Bankruptcy Review Commission recommended, and a bill by Congressman Nadler proposes, that a new section 524(k) be added to the Bankruptcy Code. This new subsection would allow an individual who has received a discharge to recover costs and attorneys fees, plus treble damages (at a minimum of $5,000), from a credit to who threatens, files suit, or otherwise seeks to collect any debt that was discharged in bankruptcy and not the subject of a reaffirmation agreement in accordance with section 524.

APPENDIX

Evaluating the impact of alternative guidelines - REVISED

The tables below are revised to reflect the fact that, if we retain the current law reliance on a 3-5 year repayment period, it will reduce the impacts of rules which rely on the debtors ability to repay relative to our earlier calculations, which assumed a 5-7 year repayment period. For example, we now find that a rule of 100% of median income and a 20% ability to repay would lead to approximately 10-11% of cases being potentially impacted by presumptive guidelines.

Table 1. Percent of Chapter 7 Filers Potentially Impacted by Gekas-type* Needs Based Provisions With Ability to Repay over 3 Years

Gross Income as a % of National Median	Filers with Monthly Net Income > $50 and Share of Unsecured Nonpriority Debt Repayable over 3 Years			
	> 20%	>30%	> 40%	> 50%
> 100%	9.9	7.9	6.5	5.4
> 110%	8.6	6.9	5.7	4.7
> 125%	6.5	5.2	4.3	3.5

*Calculations from data by Ernst & Young using 1997 VISA national bankruptcy database, debtors' expenses as allowed under HR 3150

Table 2. Percent of Chapter 7 Filers Potentially Impacted by Discretionary* Needs Based Provisions With Ability to Repay over 3 Years

Gross Income as a % of National Median	Filers with Monthly Net Income > $50 and Share of Unsecured Nonpriority Debt Repayable over 3 Years			
	> 20%	>30%	> 40%	> 50%
> 100%	11.3	9.2	7.6	6.3
> 110%	9.6	7.8	6.4	5.3
> 125%	7.0	5.7	4.7	3.9

*Calculations from data by Ernst & Young using 1997 VISA national bankruptcy database, debtors' expenses as reported in bankruptcy petitions

CLINTON-GORE ACCOMPLISHMENTS
REFORMING WELFARE

On August 22, 1996, President Clinton signed the Personal Responsibility and Work Opportunity Reconciliation Act, fulfilling his longtime commitment to 'end welfare as we know it.' As the President said upon signing, "... this legislation provides an historic opportunity to end welfare as we know it and transform our broken welfare system by promoting the fundamental values of work, responsibility, and family."

TRANSFORMING THE BROKEN WELFARE SYSTEM

- **Overhauling the Welfare System with the Personal Responsibility Act**: In 1996, the President signed a bipartisan welfare plan that is dramatically changing the nation's welfare system into one that requires work in exchange for time-limited assistance. The law contains strong work requirements, performance bonuses to reward states for moving welfare recipients into jobs and reducing illegitimacy, state maintenance of effort requirements, comprehensive child support enforcement, and supports for families moving from welfare to work -- including increased funding for child care and guaranteed medical coverage. State strategies are making a real difference in the success of welfare reform, specifically in job placement, child care and transportation.

- **Law Builds on the Administration's Welfare Reform Strategy**: Even before the Personal Responsibility Act became law, many states were well on their way to changing their welfare programs to jobs programs. By granting Federal waivers, the Clinton Administration allowed 43 states -- more than all previous Administrations combined -- to require work, time-limit assistance, make work pay, improve child support enforcement, and encourage parental responsibility. The vast majority of states have chosen to continue or build on their welfare demonstration projects approved by the Clinton Administration.

- **Largest Decline in the Welfare Rolls in History**: The President has announced that we've met -- two years ahead of schedule -- the challenge he made in last year's State of the Union to move two million more Americans off of welfare by the year 2000. New caseload numbers show that welfare caseloads fell by 4.3 million since President Clinton took office and 2.4 million in the first 13 months of the new law. The new figures, from September 1997, show 9.8 million Americans on welfare, a drop of more than 30 percent from January 1993. This historic decline occurred in response to the Administration's grants of Federal waivers to 43 states, the provisions of the new welfare reform law, and the strong economy.

MOVING PEOPLE FROM WELFARE TO WORK

- **Mobilizing the Business Community**: At the President's urging, the Welfare to Work Partnership was launched in May 1997 to lead the national business effort to hire people from the welfare rolls. Founded with 105 participating businesses, the Partnership now has over 3,000 members. The Partnership provides technical assistance and support to businesses around the country, including: a toll-free number (1-888-USAJOB1), the Partnership's Web site (www.welfaretowork.org) and a "Blueprint for Business" manual.

  ... **and Civic, Religious and Non-profit Groups**: The Vice President created the Welfare to Work Coalition to Sustain Success, a coalition of civic groups committed to helping former welfare recipients stay in the workforce and succeed. Tailoring their services to meet welfare recipients needs and the organizations' strengths, the Coalition will focus on providing mentoring and other support services. Charter members of the Coalition include: the Boys and Girls Clubs of America, the Baptist Joint Committee, the United Way, the YMCA, and other civic and faith-based groups.

- **Doing Our Fair Share with the Federal Government's Hiring Initiative**: Under the Clinton Administration, the Federal workforce is the smallest it has been in thirty years. Yet, this Administration also believes that the Federal government, as the nation's largest employer, must lead by example. The President asked the Vice President to oversee the Federal government's hiring initiative in which Federal agencies have committed to directly hire at least 10,000 welfare recipients in the next four years. Already, the federal government has hired over 3,600 welfare recipients. As a part of this effort, the White House pledged, and has already hired, six welfare recipients.

- **$3 Billion to Help Move More People from Welfare to Work**: Because of the President's leadership, the 1997 Balanced Budget Act included the total funding requested by the President for the creation of his $3 billion welfare to work fund. This program will help states and local communities move long-term welfare recipients into lasting, unsubsidized jobs. These funds can be used for job creation, job placement and job retention efforts, including wage subsidies to private employers and other critical post-employment support services. The Department of Labor will provide oversight but most of the dollars will be placed, through the Private Industry Councils, in the hands of the localities who are on the front lines of the welfare reform effort. In addition, 25 percent of the funds will be awarded by the Department of Labor on a competitive basis to support innovative welfare to work projects.

- **Tax Credits for Employers**: The Welfare to Work Tax Credit, enacted in the 1997 Balanced Budget Act, provides a credit equal to 35 percent of the first $10,000 in wages in the first year of employment, and 50 percent of the first $10,000 in wages in the second year, to encourage the hiring and retention of long term welfare recipients. This credit complements the Work Opportunity Tax Credit, which provides a credit of up to $2,400 for the first year of wages for eight groups of job seekers. The President's FY 1999 budget extends these two important tax credits for an additional year.

- **Welfare to Work Housing Vouchers**: In his FY 1999 budget, the President proposes $283 million for 50,000 new housing vouchers for welfare recipients who need housing assistance to get or keep a job. Families could use these housing vouchers to move closer to a new job, to reduce a long commute, or to secure more stable housing to eliminate emergencies that keep them from getting to work every day on time. These vouchers, awarded to communities on a competitive basis, will give people on welfare a new tool to make the transition to a job and succeed in the work place.

- **Welfare to Work Transportation**: One of the biggest barriers facing people who move from welfare to work -- in cities and in rural areas -- is finding transportation to get to jobs, training programs and child care centers. Few welfare recipients own cars. Existing mass transit does not provide adequate links to many suburban jobs at all, or within a reasonable commute time. In addition, many entry level jobs require evening or weekend hours that are poorly served by existing transit routes. To help those on welfare get to their jobs, President Clinton has proposed a $100 million a year welfare to work transportation plan as part of his ISTEA reauthorization bill. This competitive grant program would assist states and localities in developing flexible transportation alternatives, such as van services.

PROMOTING PERSONAL RESPONSIBILITY

- **Enforcing Child Support -- 63% Increase in Collections**: The Clinton Administration collected a record $13 billion in child support in 1997 through tougher enforcement, an increase of $5 billion, or 63% since 1992. Not only are collections up, but the number of families that are actually receiving child support has also increased. In 1997, the number of child support cases with collections rose to 4.2 million, an increase of 48% from 2.8 million in 1992. And paternity establishment, often the first crucial step in child support cases, has dramatically increased. In 1997, the number of paternities established or acknowledged rose to 1.1 million from 512,000 in 1992, an increase of 115%.

  Making Deadbeat Parents Pay: The President's unprecedented and sustained campaign to make deadbeat parents pay is working. In addition to tougher enforcement including a strong partnership with states, President Clinton has taken executive action including: directing the Treasury Department to collect past-due child support from Federal payments including Federal income tax refunds and employee salaries; taking steps to Federal deny loans to any delinquent parents; issuing an executive order making the Federal government a model employer in the area of child support enforcement. The President also directed the Attorney General to submit legislation that strengthens the Child Support Recovery Act by prosecuting more parents who take egregious actions to avoid paying child support. And most significantly, the welfare reform law contains tough child support measures that President Clinton has long supported including: a national new hire reporting system; streamlined paternity establishment; uniform interstate child support laws; computerized state-wide collections; and tough new penalties. These five measures are projected to increase child support collections by an additional $24 billion over the next ten years.

- **Breaking the Cycle of Dependency -- Preventing Teen Pregnancy**: Significant components of the President's comprehensive effort to reduce teen pregnancy became law when the President signed the 1996 Personal Responsibility Act. The law requires unmarried minor parents to stay in school and live at home or in a supervised setting; encourages "second chance homes" to provide teen parents with the skills and support they need; and provides $50 million a year in new funding for state abstinence education activities. Since 1993, the Clinton Administration has supported innovative and promising teen pregnancy prevention strategies; HHS-supported programs already reach about 30 percent or 1,410 communities in the United States. As part of this effort, the National Campaign to Prevent Teen Pregnancy, a private nonprofit organization, was formed in response to the President's 1995 State of the Union. Notably, data shows we are making progress in reducing teen pregnancy -- teen births have fallen five years in a row, by 12 percent from 1991 to 1996.

RESTORING FAIRNESS AND PROTECTING THE MOST VULNERABLE

The President made a commitment to fix several provisions in the welfare reform law that had nothing to do with moving people from welfare to work. In 1997, the President fought for and ultimately was successful in ensuring that the Balanced Budget Act protects the most vulnerable. And now, with his 1999 budget, he's continuing the fight.

- **Protects Immigrants Who Become Disabled and Those Currently Receiving Benefits**: The Balanced Budget Act of 1997 restored $11.5 billion in SSI and Medicaid benefits for legal immigrants. The new law protects those immigrants now receiving assistance, ensuring that they will not be turned out of their apartments or nursing homes or otherwise left destitute. And for immigrants already here but not receiving benefits, the BBA does not change the rules retroactively. Immigrants in the country as of August 22, 1996 but not receiving benefits at that time who subsequently become disabled will also be fully eligible for SSI and Medicaid benefits.

- **Helps People Who Want to Work but Can't Find a Job**: The Balanced Budget Act (BBA) also restored $1.5 billion in food stamp cuts. The welfare reform law restricted food stamps for able-bodied childless adults to only 3 out of every 36 months, unless they were working. This move ignored the fact that finding a job often takes time. The BBA provided funds for an estimated 235,000 work slots over 5 years and food stamp benefits to those who are willing to work but, through no fault of their own, have not yet found employment. In addition, the BBA allows states to exempt up to 15 percent of the food stamp recipients (70,000 individuals monthly) who would otherwise be denied benefits as a result of the "3 in 36" limit.

- **Food Stamps for Legal Immigrants**: The President's 1999 budget proposes to restore Food Stamp benefits for vulnerable groups of legal immigrants. The President's proposals would provide Food Stamp benefits to 730,000 legal immigrants in 1999 at a cost of $2.5 billion over 5 years. Specifically, benefits would be restored for: all families with children; immigrants with disabilities and elderly immigrants age 65 and older who entered the U.S. before welfare reform was enacted, on the same basis as the SSI and Medicaid restorations in the 1997 BBA; refugees and asylees, whose eligibility would be extended from 5 to 7 years; Hmong immigrants who came to the U.S. after the Vietnam war; and certain Native Americans living along the Canadian and Mexican borders.

- **Protects Children by Keeping the Medicaid Guarantee**: The BBA preserved the Federal guarantee of Medicaid coverage for the vulnerable populations who depend on it, and contains additional investments to extend coverage to uninsured children. It also ensures that 30,000 disabled children losing SSI because of the new tighter eligibility criteria keep their Medicaid coverage. The President's 1999 budget proposes to provide States the option to provide health care coverage through Medicaid and the Children's Health Insurance Program (CHIP) for legal immigrant children, regardless of when they entered the U.S.

2/9/98

FYI, this is the draft Administration position paper, which outlines the problems with the conference report bill.

Statement of Administration Position -- DRAFT

The Senate worked on a bipartisan basis to produce a responsible and balanced bill that would have reduced abuses of the bankruptcy system and required debtors and creditors alike to act responsibly. Unfortunately, H.R. 3150, as agreed to by the Conference Committee, contains many flawed aspects of the House bill, and if this version of the bill is presented to the President, his senior advisors will recommend that he veto it.

On the central issue of means-testing, the Conference Report uses the Senate framework but would, like the House bill produce a rigid and formulaic approach that denies bankruptcy judges adequate discretion to decide whether the debtor has the capacity to repay successfully a portion of debts under Chapter 13. Moreover, the bill would require a moderate income debtor to demonstrate that each monthly expense for housing, clothing, transportation, and food that exceeds an IRS determined level is necessary due to "extraordinary circumstances" before that person could get their debts discharged under Chapter 7.

At the same time H.R. 3150 produces a rigid system to ensure moderate-income debtors repay their debts, it weakens meaningful limits on the homestead exemption --the mechanism used by the wealthy to shield hundreds of thousands of dollars of wealth from their creditors.

The Senate bill took laudable steps to enhance consumer protections from coercive and predatory behavior by creditors. This version of H.R. 3150, however, fails to limit abusive creditor practices such as coercive affirmations and violations of the automatic stay, and rolls back consumer protections. The bill would also deny consumers the most effective remedy for harm from such practices --class action liability --and eliminate the current authorization for punitive damages against creditors for intentional violations of borrower rights.

Finally, the bill does not include the provisions of the Senate bill that would discharge debts that could compete with child support and alimony payments after a debtor has been declared bankrupt. In addition, the bill would make nondischargeable debt that was incurred within 90 days of bankruptcy to pay nondischargeable debt and debt resulting from certain cash advances. This, in effect, puts debt owed to credit card companies on the same plane as other social priorities like child support and alimony, taxes, and educational loans. All too often a debtor struggling to pay child support and alimony lets children and ex-spouses come last when faced with pressures from an aggressive creditor trying to collect nondischargeable debt.

The overwhelming vote on the Senate floor for the balanced legislation that body produced demonstrates that reasonable and responsible bankruptcy reform is possible. Unfortunately, H.R. 3150 as developed by the Conference Committee, does not provide such reform.

Impact of Bankruptcy on Credit Card Interest Rates

- For a long time, the credit card industry was not very competitive, profits were high, and credit card interest rates were unresponsive to other interest rates (Ausubel, 1991).

- Over the course of the 1990s, this changed. Most observers now characterize it as an intensely competitive industry where issuers compete in large part by offering consumers lower interest rates. Rates have fallen substantially (chart 1) even as chargeoff losses have risen (chart 2), driving profit rates down sharply: In 1997 the average banking industry Return on Assets (ROA) was 1.94 percent for non-credit-card operations and 2.13 percent for credit card operations.

- In 1997, credit card issuers had to write off over 6 percent of assets as uncollectable, with somewhat less than half of chargeoffs reflecting bankruptcy losses; chargeoffs have been rising sharply in recent years, in parallel with the rising bankruptcy rate.

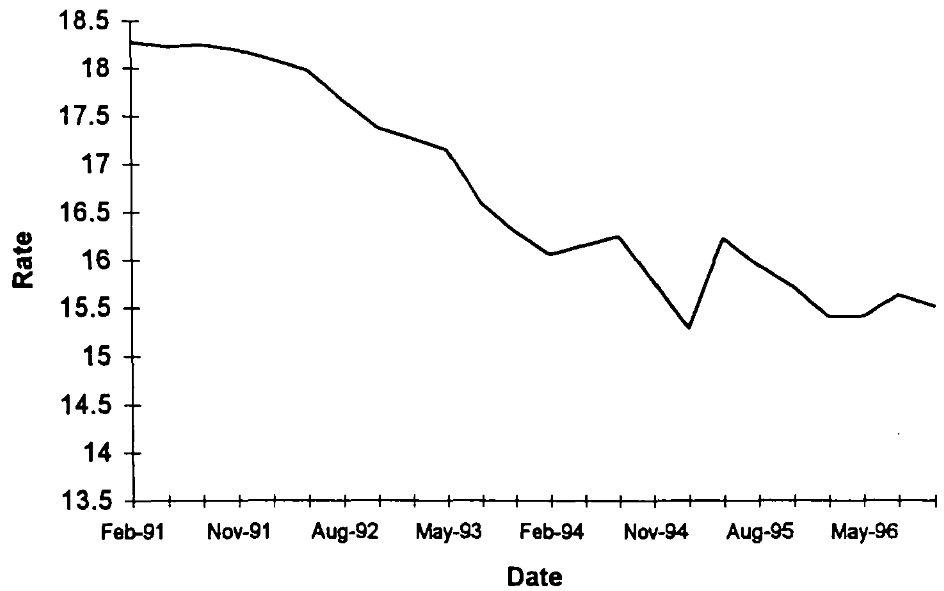
- Industry trade publications have run several articles in the last few years examining the performance of alternative models of bankruptcy risk; the explicitly stated purpose of these models is to help issuers determine bankruptcy risks so that correspondingly higher interest rates can be charged.

- When a private marketing survey asked issuers what were the primary factors in setting interest rates, the ranking was (1) competition; (2) cost of funds; (3) operations costs.

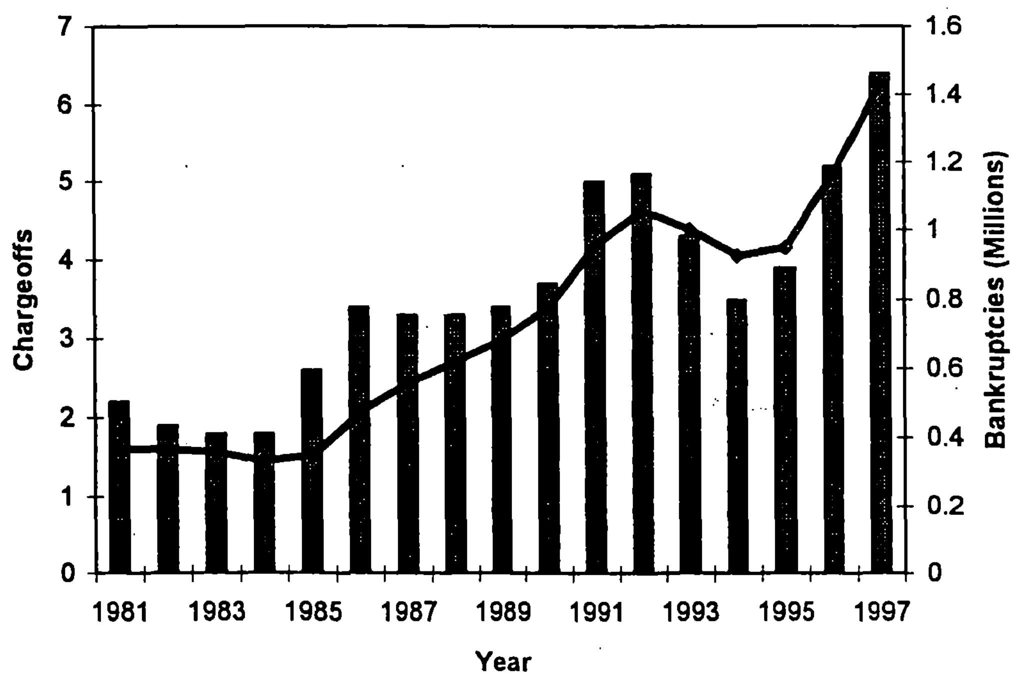
- According to the most recent Federal Reserve annual report to Congress on the credit card industry, "Competition in the credit card market remains intense, with thousands of firms offering bank cards to consumers. Prior to the early 1990s, card issuers competed primarily by waiving annual fees and providing credit card program enhancements. Since then, however, interest-rate competition has played a much more prominent role. Many credit card issuers, including nearly all of the largest issuers, have lowered interest rates on many of their accounts ... Credit card interest rates in general have become more responsive to issuers' costs of funds (currently, about 70 percent of card issuers tie their interest rates directly to an index that moves with market rates). ... Several of the more rapidly growing firms in recent years have attracted market share by offering comparatively low-rate cards. ... credit card interest rates fell sharply from mid-1991 through early 1994 ... The general decline in credit card interest rates from mid-1991 is the result of many factors, including much more pronounced competition based on this aspect of credit card pricing. The decline in rates also reflects, in large measure, the sharp drop in credit card issuers' costs of funds in the early part of this period."

In sum, the largest portion of expenses is chargeoffs (which are heavily related to bankruptcy), profit rates are no longer particularly high, and both trade journals and regulators emphasize competition on interest rates as a driving force in the industry today. It is difficult to avoid the conclusion that a large part of the reason credit card interest rates remain so high is that issuers must cover the losses they incur from bankruptcies of card users.

Average Credit Card Interest Rate



Bankruptcy Rate vs. Chargeoffs



Date: Tuesday, March 17, 1998
FACT SHEET
Contact: ACF Press Office (202) 401-9215

CHILD SUPPORT ENFORCEMENT: A CLINTON ADMINISTRATION PRIORITY

__Overview:__ The goal of the Child Support Enforcement (CSE) program, established in 1975 under Title IV-D of the Social Security Act, is to ensure that children are supported financially by both parents.

Designed as a joint federal, state, and local partnership, the program involves 54 separate state and territory systems, each with its own unique laws and procedures. The program is usually run by state and local human service agencies, often with the help of prosecuting attorneys and other law enforcement officials as well as officials of family or domestic relations courts. At the federal level, the Department of Health and Human Services provides technical assistance and funding to states through the Office of Child Support Enforcement and also operates the Federal Parent Locator System, a computer matching system that locates non-custodial parents who owe child support.

Despite recent record improvements in paternity establishment and child support collections, much more needs to be done to ensure that all children born out-of-wedlock have paternity established and that all non-custodial parents provide financial support for their children. Currently, only about one-half of the custodial parents due child support receive full payment. About twenty-five percent receive partial payment and twenty-five percent receive nothing.

For that reason, President Clinton proposed, and Congress passed, legislation to strengthen and improve state child support collection activities. These provisions, included in the Personal Responsibility and Work Opportunity Act of 1996, could increase child support collections to over $24 billion in 10 years: a national new hire reporting system, streamlined paternity establishment, uniform interstate child support laws, computerized state-wide collections, and tough new penalties, such as driver's license revocation.

Clinton Administration Increases and Innovations

President Clinton has made improving child support enforcement and increasing child support collections a top priority. Since taking office, President Clinton has cracked down on non-paying parents and strengthened child support enforcement, resulting in record child support collections: In FY 1997, the federal-state partnership collected a record $13 billion from non-custodial parents, an increase of $5 billion, or 63 percent, since 1992. The number of families that are actually receiving child support has also increased: In 1997, the number of child support cases with collections rose to 4.2 million, an increase of 48 percent from 2.8 million in 1992.

Encouraging state innovations. On October 10, 1997, HHS announced the award of $1.5 million in demonstration grants to 17 states to support innovative projects to improve the nation's child support enforcement program. The projects will test cooperation with child support requirements by applicants for and recipients of Temporary Assistance to Needy Families; new models for coping with domestic violence in the context of child support enforcement; models of collaboration between child support enforcement, Head Start and Child Care programs at the state and local levels; collaborations to facilitate family preservation between child support and child welfare programs; reviewing and adjusting child support orders; determining the effect of child support collections on welfare recipient income; and, models for making the child support enforcement program responsive to the needs of low-income noncustodial fathers to encourage greater parental responsibility. In addition, HHS on December 18, 1997, HHS announced approval of a child support waiver to allow the State of Washington to use federal funds normally used for child support enforcement to fund "Devoted Dads," an innovative public/private partnership to promote the responsible roles of fathers in the financial and emotional support of their children. The project, which serves the Tacoma, Washington Enterprise Community, intends to reach non-custodial parents, particularly young and at-risk fathers. This demonstration is the first child support waiver granted for an enterprise community.

Executive action. While working toward comprehensive improvement of child support enforcement, President Clinton used his executive authority to increase child support collections. Since taking office, President Clinton has directed the Treasury Department to activate a centralized, streamlined Federal system to offset child support debts against most Federal payments; ordered Federal agencies to take necessary steps to deny loans, loan guarantees, or loan insurance to any individual who is delinquent on child support debt; implemented a new program that will help track non-paying parents across state lines; proposed new regulations requiring women who apply for welfare to comply with paternity establishment requirements before receiving benefits; and issued an executive order to make the federal government a model employer in the area of child support enforcement. In addition, the Clinton Administration granted welfare reform waivers to a record 43 states. More than two-thirds of these states pursued innovative child support reforms under waivers approved by the Clinton Administration.

Increasing resources. President Clinton has proposed annual expansions in child support enforcement, increasing resources by 53 percent since taking office. HHS has also launched an initiative and given demonstration grants to states to promote improved performance, service quality and public satisfaction in the child support program. The President's FY 1999 budget proposal allocates $3.2 billion to state child support enforcement programs, a 19 percent increase over FY 1998.

Prosecuting non-payers. Billions of dollars more in support is owed to children whose parents have crossed state lines and failed to pay. The Justice Department is investigating and prosecuting cases where parents cross state lines to avoid payment under the Child Support Recovery Act. At President Clinton's direction, the Justice Department submitted legislation to Congress in September 1996 that would make it a felony offense to cross state lines to evade a child support obligation if the obligation has remained unpaid for longer than one year or is greater than $5,000; or to willfully fail to pay a child support obligation for a child living in another state if the obligation has remained unpaid for a period longer than two years or is greater than $10,000.

Seizing tax refunds. The Federal government collected a record $1.1 billion in delinquent child support by intercepting income tax refunds of non-paying parents for tax year 1996. The amount was 10 percent higher than the previous year, and up 66 percent since 1992. Nearly 1.3 million families benefited from these collections.

Improving paternity establishment. The Clinton Administration has made paternity establishment a top priority. In FY 1997, 1.1 million paternities were established -- a 115 percent increase from 1992. In 1993, the Clinton Administration proposed, and Congress adopted, a requirement that states establish hospital-based paternity programs as a proactive way to establish paternities early in a child's life. Preliminary data from thirty-two states indicates that more than 285,000 paternities were established through the program in 1996.

U.S. Postal Service posts "wanted lists." The U.S. Postal Service is working with states to display "Wanted Lists" of parents who owe child support in post offices. Each state that has such a list will be able to provide it to the Postal Service, and the list will be displayed in post offices within that state. The President has also challenged every state to create a "Wanted List" to expand efforts to track down parents who owe support and send the strongest possible message that evasion of child support responsibilities is a serious offense.

Action through the Internet. HHS's Office of Child Support Enforcement now has a home page on the Internet that provides information on the child support enforcement program, tells parents where they can apply for child support assistance, and provides links to states that have their own home pages (currently 37).

Improvements Under the Personal Responsibility and Work Opportunity Act of 1996

At President Clinton's urging, the new welfare reform law includes the child support enforcement measures the President proposed in 1994 -- the most sweeping crackdown on non-paying parents in history. Under the new law, each state must operate a child support enforcement program meeting federal requirements in order to be eligible for Temporary Assistance to Needy Families (TANF) block grants. Provisions include:

National new hire reporting system. The law establishes a Federal Case Registry and National Directory of New Hires to track delinquent parents across state lines. It also requires that employers report all new hires to state agencies for transmittal of new hire information to the National Directory of New Hires. This builds on President Clinton's June 1996 executive action to track delinquent parents across state lines. The law also expands and streamlines procedures for direct withholding of child support from wages. The directory began operation on schedule in October 1997. To date, the directory has found over 90,000 delinquent parents who owe child support.

Streamlined paternity establishment. The new law streamlines the legal process for paternity establishment, making it easier and faster to establish paternities. It also expands the voluntary in-hospital paternity establishment program, started by the Clinton Administration in 1993, and requires a state affidavit for voluntary paternity acknowledgment. These affidavits must meet minimum requirements set by the Secretary of HHS. In addition, the law mandates that states publicize the availability and encourage the use of voluntary paternity establishment processes. Individuals who fail to cooperate with paternity establishment will have their monthly cash assistance reduced by at least 25 percent.

Uniform interstate child support laws. The new law provides for uniform rules, procedures, and forms for interstate cases.

Computerized state-wide collections. The new law requires states to establish central registries of child support orders and centralized collection and disbursement units. It also requires expedited state procedures for child support enforcement.

Tough new penalties. Under the new law, states can implement tough child support enforcement techniques. The new law will expand wage garnishment, allow states to seize assets, allow states to require community service in some cases, and enable states to revoke driver's and professional licenses for parents who owe delinquent child support.

"Families First." Under a new "Family First" policy, families no longer receiving assistance will have priority in the distribution of child support arrears. This new policy will bring families who have left welfare for work about $1 billion in support over the first six years.

Access and visitation programs. In an effort to increase noncustodial parents' involvement in their children's lives, the new law includes grants to help states establish programs that support and facilitate noncustodial parents' visitation with and access to their children. On October 3, 1997, HHS announced the award of $10 million in grants to all 50 states, the District of Columbia, and U.S. territories to promote access and visitation programs. The minimum allotment per state for FY 1997 is $50,000.

New state incentives. Current law provides for HHS to make incentive payments to states for their child support enforcement systems, but these payments are based on only one factor: cost-effectiveness. Under the new welfare reform law, HHS was authorized to prepare an alternative incentive plan. On March 13, 1997, Secretary Shalala submitted a proposal to Congress which was designed to further improve the performance of state child support enforcement programs by linking federal incentive payments to states to their performance in five key areas: establishment of paternities, establishment of child support orders, collections on current child support owed, collection on previously or past due child support owed, and cost-effectiveness. To reinforce the goal of achieving self-sufficiency, states will be rewarded for collection in all child support cases, but with a stronger emphasis on welfare and former welfare cases. On September 16, 1997, Secretary Shalala joined Rep. Clay Shaw, chairman of the House Ways and Means Subcommittee on Human Resources, and Rep. Sandy Levin, the ranking minority member of the subcommittee, in announcing legislation that is drawn from the HHS proposal. The House of Representatives passed the bill on September 30, 1997, and the Senate will consider the legislation in 1998.

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