Bankruptcy—Misc Amdts

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Sandra Yamin
11/08/99 04:19:15 PM

Record Type: Record

To: John Podesta/WHO/EOP@EOP, Lawrence J. Stein/WHO/EOP@EOP, Gene B. Sperling/OPD/EOP@EOP, Bruce N. Reed/OPD/EOP@EOP

cc: See the distribution list at the bottom of this message
Subject: FINAL CLEARANCE -- S. 625 - Bankruptcy Reform Act of 1999

Attached for your clearance is the final draft SAP on S. 625 -- Bankruptcy Reform Act. The Senate began consideration of S. 625 on Friday, Nov 5. Appreciate your sign-off/comments on the attached by 5PM TODAY. My apologies for the short turnaround. Thank you!

Bruce: Sylvia and Sally have requested that I bring your attention to the paragraph on the drug related amendment at the end of the SAP right before the attachement. They both wanted to make sure that the last sentence in this paragraph was accurate. Thank you!

DRAFT

November 8, 1999
(Senate)

S. 625 - Bankruptcy Reform Act of 1999
(Grassley (R) Iowa and eight cosponsors)

The President supports bankruptcy reform that is balanced, would reduce abuses of the bankruptcy system, and would require debtors and creditors alike to act responsibly. Last year, the Senate produced such a balanced bill with overwhelming bipartisan support. The President is disappointed that, this year, the House failed to produce legislation that he could support. S. 625 reflects some improvements over H.R. 833 as passed by the House. The Administration, however, continues to have serious reservations about S. 625 and strongly opposes some of its provisions. For example, we are deeply concerned about a provision of the manager's amendment that adds an important "safe harbor" that protects low-income debtors from motions to deny them access to Chapter 7 under the means test, but also eliminates an essential "safe harbor" that would protect low-income debtors from coercive creditor motions that might be brought under a under a vague "totality of the circumstances" test more appropriately enforced by bankruptcy trustees and courts. That safe harbor provision was included in the reported version of the Senate bill, the House-passed bill, and last year's conference report. The Administration's other objections to this bill are explained in detail in the Attachment.

Most of the Administration's concerns would be addressed by relevant amendments that the Administration understands will be offered on the Senate floor. The Administration's views on the anticipated amendments are also contained in the Attachment. The Administration remains hopeful that bipartisan cooperation will result in responsible bankruptcy legislation that the President can enthusiastically sign.

Finally, the Administration understands that certain non-relevant amendments will be offered as well. On November 4, 1999, in a letter to the Majority Leader, the President made clear that he strongly supports an increase in the minimum wage of $1 over the next two years; however, if Congress sends him a bill that plays politics with the minimum wage by delaying the increase, repealing overtime protections for certain workers, adding costly and unnecessary tax cuts that threaten fiscal discipline and direct benefits away from working families, and thwarting ongoing efforts to enforce pension law, he will veto it.

In addition, the Administration strongly opposes the inclusion of an unrelated education amendment, a version of the Teacher Empowerment Act, that is even more objectionable than the House-passed bill, which the President's senior advisors recommended that he veto. The amendment would gut the class size reduction program passed on a bipartisan basis last year and replace it with a block grant that fails to guarantee that any funds will be used to support the crucial work of reducing class sizes in the early grades. In addition, the block grant does not target funds toward the neediest students and does not include important provisions to improve teacher quality. If this amendment is attached to S. 625, the President's senior advisors will recommend that he veto the bill.

The Administration opposes the drug-related amendment because it would address the current disparity between crack and powder cocaine penalties solely by increasing powder cocaine penalties dramatically instead of addressing both crack and powder cocaine penalties. Decreasing the threshold amount of powder cocaine necessary to obtain 5- and 10-year mandatory minimum sentences may be counterproductive if it redirects Federal law enforcement resources from the highest level offenders. In addition, this amendment would actually exacerbate the disproportionate impact of cocaine sentencing on minorities because, according to U.S. Sentencing Commission statistics, approximately 31% of defendants sentenced at the Federal level for powder cocaine offenses in 1998 were African American, 48% were Hispanic, and only 19% were white.

* * * * * * *

Attachment

Detailed Administration Views on S. 625 and Anticipated Floor Amendments

Access to Chapter 7. Any means test used in bankruptcy proceedings should deny access to Chapter 7 bankruptcy procedures only to those debtors who genuinely have the capacity to repay a portion of their debts successfully under a Chapter 13 repayment plan. Debtors who may be denied a discharge of their debts must be given a meaningful opportunity to have their specific circumstances considered by bankruptcy courts with the authority to determine whether they genuinely have the capacity to repay a portion of their debts. In its current form, S. 625 would use a relatively inflexible and arbitrary means test to limit access to Chapter 7. The Administration strongly opposes this provision.

As reported, S. 625 would apply rough guidelines, developed by the Internal Revenue Service (IRS) for tax repayment plans, as standards for determining debtors' ability to repay, with exceptions only for expenses that are both "reasonable and necessary." While some expense standards should be used to guide the determination of ability to repay, they should be tailored for bankruptcy. We should not simply import standards that were developed for a different purpose -- tax collection - and which are applied for that purpose with far more discretion than S. 625 would allow for bankruptcy. We note that the Congress has criticized the IRS for inadequate flexibility in using these standards for tax collection, yet this bill would use them far more rigidly for bankruptcy purposes. The Administration believes that the IRS expense formulas can be used as a starting point for developing appropriate bankruptcy guidelines, but that each system would be best served by its own appropriate standards. As House Judiciary Committee Chairman Henry Hyde has said, the use of IRS guidelines without flexibility " depriv[es] debtors and their families of the means to pay for their basic needs." As Chairman Hyde noted on the House floor, "The cost of food in Omaha, Nebraska, or Boise, Idaho, is different than in downtown Manhattan. So what is realistic about an inflexible standard?"

The Senate bill creates a largely self-executing mechanism under which elaborate debtor filings will be reviewed by United States trustees, who, based on the filings, will file a motion to deny access to Chapter 7, if the debtor has the capacity to repay or her use of Chapter 7 is abusive. As modified by the managers' amendment, the bill also gives creditors the ability to file motions to challenge the debtors' use of Chapter 7 as abusive under a vague "totality of the circumstances" test. Creditor motions alleging abuse could be used by creditors against low and moderate income debtors - who have few resources for legal advice -- to coerce or threaten them to forgo their rights. The bill should provide below-median-income debtors with a "safe harbor" from general abuse motions by creditors, as well as with the "means-test safe harbor" that the managers' amendment provides. Both are essential.

Finally, since the bill as amended by the managers' amendment precludes any party from filing a 707(b) motion alleging that a below-median income debtor has the capacity to repay under the means test, there is no justification for requiring that these debtors fulfill the elaborate means test paperwork requirements. The courts will bear unnecessary costs for collection and storage of these useless filings and they impose an unnecessary cost (and increased legal fees) on the debtor as well. These debtors should be required to provide only the information sufficient to verify their income eligibility for the "safe harbor." Similarly, a more streamlined system could screen out those with no capacity to repay before additional paperwork requirements are imposed. All parties should be able to agree that any means test should be implemented efficiently. Burdensome filing and hearing requirements that lead to little or no additional debt repayment are not in the interest of debtors, creditors, or taxpayers.

The Administration understands that a series of amendments will be offered to improve the fairness and efficiency of the means test. The Administration strongly supports these amendments, including:

abAn amendment by **Senator Feingold** to clarify that the long-term care expenses of a debtor caring for a non-dependent parent or relative are necessary expenses under the means test;

abA similar amendment by **Senator Leahy** to clarify that certain expenses for victims of domestic abuse are necessary expenses under the means test;

abA similar amendment by **Senator Schumer** to clarify that retraining expenses of displaced or unemployed workers are necessary expenses under the means test;

abAn amendment by **Senator Dodd** to address special concerns of children and families, which includes a provision to clarify that the expenses associated with adopting a child are necessary expenses under the means test;

abAn amendment by **Senators Schumer and Durbin** to provide an appropriate safe harbor from all types of creditor motions and unnecessary paperwork requirements for below-median-income debtors;

abAn amendment by **Senator Durbin** to reduce unnecessary costs and inefficiency in the reformed bankruptcy system by streamlining application of the means test and reducing costly paperwork collections without affecting debt repayment under the system;

abAn amendment by **Senator Schumer** to authorize the Treasury Department, in consultation with the Executive Office for United States Trustees, to modify certain of the IRS guidelines for use in bankruptcy to account for variations in the cost of living; and

abAn amendment by **Senator Schumer** to improve the accuracy of the means test calculation by counting all required Chapter 13 expenses (administrative costs, reasonable attorneys fees, and arrearages on other debt) in calculating capacity to repay under the means test.

Abusive Creditor Reaffirmation Practices. Much evidence shows that debtors often reaffirm unsecured debt and low-value secured debt on unfavorable terms even though they do not have the means to meet their own necessary expenses and make more important debt payments, placing such priority debts as child support and alimony obligations at risk. Such reaffirmations frequently are the result of insufficient or misleading information or threats from creditors. S. 625 as reported does little to address these abuses. If we are to provide substantial new opportunities for creditors to challenge debtors' use of the bankruptcy system under Chapter 7 of the Bankruptcy Code, we must limit abusive creditor practices such as coercive reaffirmations and violations of the automatic stay against collection actions. We understand Senator Sessions may offer an amendment to provide some protections against abusive reaffirmations. However, we believe the amendment has significant loopholes, allowing debtors to reaffirm debts they cannot afford and failing to provide creditors with all the information that bankruptcy judges deem necessary and which many are already requiring be provided in their courts. The Administration strongly supports:

ab An amendment by **Senator Reed**, that protects debtors by giving them adequate information for decisions about significant reaffirmations of unsecured and low-value secured debt.

Credit Card Information and Protection. The Administration continues to believe that reform must address the factor that is most strongly correlated with the rise in personal bankruptcy: rising levels of consumer debt. Americans now receive more than 3.5 billion credit card solicitations per year, many of which are marketed to encourage consumers to carry high balances and incur large interest charges. One of the most effective ways to reduce the number of bankruptcies in this new financial era is to give consumers the information they need to manage their credit card debts effectively, recognizing the creditors' superior information and bargaining ability. Consumers must be given clear information on the terms of their credit and the financial implications of not paying off their credit card balances. The Administration supports:

abAn amendment by **Senators Grassley, Torricelli, Biden, and Johnson** addressing some abusive credit practices, such as failure to disclose "teaser" rates clearly, and requiring limited generic disclosure of the impact of making only the minimum payment on credit cards.

While the Grassley-Torrecelli amendment is an improvement over H.R. 833, much more should be done. The amendment creates a system that is unnecessarily burdensome for consumers who may be reluctant to call their credit card company if they are worried about their finances or are pressed for time. The Administration strongly supports:

abAn amendment by **Senator Schumer** to expand coverage of the teaser rate disclosures provided under the amendment by Senator Grassley and Torrecelli to apply to applications or solicitations available to the public in catalogs, magazines, and restaurants; and

abAn amendment by **Senator Dodd** to require additional information specific to the individual consumer to allow them to better understand the impact of making only the minimum payment.

Cramdowns. S. 625 also changes the lien stripping or "cramdown" provisions in current law governing a Chapter 13 bankruptcy, under which the lien underlying a secured debt is reduced to its value at the time of bankruptcy. The Administration agrees that lien stripping should be limited to automobile loans incurred in the period preceding bankruptcy to prevent abuses, but believes that the provisions in the Senate bill are excessive. While the Administration strongly prefers the Senate provisions to the extreme prohibitions in H.R. 833, the five-year prohibition on lien stripping on automobile debts in the current bill will do little more to deter bankruptcy abuses than a more reasonable time limit. Instead, the prohibition will significantly reduce repayment of priority, unsecured debts like child support and taxes. The Administration strongly supports:

abAn amendment by **Senator Kohl** that would ban cramdowns of secured goods with purchase money security interests incurred within six months of the bankruptcy filing.

Nondischargeable Debts. The Bankruptcy Code makes debts nondischargeable 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. In an attempt to deal with the possibility of abuse, the bill makes nondischargeable debt incurred on the eve of bankruptcy and certain debts incurred to pay nondischargeable debts. Unfortunately, the amendment will catch those who innocently incur debts as well. Moreover, the additional credit card and other nonpriority debts made nondischargeable by these provisions will compete in some cases after bankruptcy with child support, alimony, taxes, and other societal priorities like educational loans and taxes. The Administration strongly prefers the provisions in S. 625, which offer some protection for child support and alimony, to those in H.R. 833. However, the Administration also strongly supports:

abAn amendment by **Senator Moynihan** that would preserve the current nondischargeability rules for lower income debtors, those least likely to incur debts on the eve of bankruptcy for abusive purposes; and

abAn amendment by **Senator Dodd** to address special concerns of children and families, which includes a provision to alter the bill's nondischargeability provisions to make it less likely that debts legitimately incurred to support a family will be made nondischargeable.

An amendment by **Senator Schumer** that would make court-ordered fines and debts resulting from abortion clinic violence nondischargeable. As the Justice Department noted in a May 14, 1999 letter to Senator Schumer, the Administration generally opposes the expansion of nondischargeable debt unless there is an overriding public policy objective and no other way to achieve that objective, but believes this amendment is a necessary tool in current efforts to end clinic violence and intimidation.

Loopholes for the Wealthy. The Administration supports closing loopholes in bankruptcy law, such as unlimited homestead exemptions, that allow many wealthy debtors to avoid their responsibility to repay a significant portion of their debt. Bankruptcy reform should not place a greater responsibility for debt repayment on moderate- and low-income debtors than it does on high-income debtors. The Administration strongly supports:

bb An amendment by **Senator Kohl** to place a reasonable limit on homestead exemptions.

Barriers to Entry to the Bankruptcy System. Finally, the bill appears to place unnecessary barriers to entry into the bankruptcy system that will not prevent abuse, but will create burdens on those with a genuine need for speedy bankruptcy protection. The Administration strongly supports:

abAn amendment by **Senator Leahy** to save the taxpayers an estimated $24 million over five years by eliminating the requirement that every debtor file three years of tax returns and instead permit any party in interest to demand the copies when needed to verify the debtor's assets and income, thus reducing filing and storage costs and unnecessary paperwork burdens; and

abAn amendment by **Senator Durbin** to allow certain mandatory credit counseling to be provided over the phone.

(Do Not Distribute Outside Executive Office of the President)

This Statement of Administration Policy was developed by the Legislative Reference Division (Jones), in consultation with the: Departments of Justice (Jones), the Treasury (Dorsey), Commerce (Clark), Labor (Greene), and State (Harrison); the Small Business Administration (Cupp); the National Labor Relations Board (Higgins); the National Economic Council (Rosen); the Office of National Drug Control Policy (Jurith); and the National Security Council (Wescott). Within OMB it was reviewed by Economic Policy (Minarik), EIMLD (Chow, Matlack, Bond, Cassell), and HTFD (Veenstra).

The Departments of Education, Agriculture, the Interior, HUD, and HHS; the Farm Credit Administration; the Consumer Product Safety Commission; the Export-Import Bank; the CEA; OMB GC; VAPD, HRD, NRD, TCJSD, BASD, and BRCD did not respond to our request for comments on the draft SAP.

OMB/LA Clearance:

S. 625 was ordered reported, as amended, by the Senate Judiciary Committee by a 14-4 vote on April 22, 1999.

Administration Position to Date

In an April 9th letter to Sen. Hatch, Chairman of the Senate Judiciary Committee, the Department of Justice described five general principles that the Administration would look for in a bankruptcy reform and proposed numerous amendments to the bill. Some of the proposed amendments have been incorporated into the reported version of the bill.

Summary of S. 625

[Note: This summary is based on the reported version of S. 625.]

S. 625 contains more than 130 provisions that would affect Federal bankruptcy law. The most significant of these changes are summarized below.

Needs-Based Bankruptcy S. 625 would:

- Limit access to Chapter 7 bankruptcy by dismissing, as a presumed abuse of the Bankruptcy Code, petitions from debtors whose monthly income: (1) is greater than the State or national median monthly income (whichever is greater) for a family of equal or lesser size; and (2) is sufficient, after deducting living expenses based on IRS guidelines, to permit them to repay at least 25 percent of non-priority unsecured debts or $15,000 over 60 months. The debtor may rebut the presumption of abuse by demonstrating "special circumstances" that justify additional expenses or an adjustment of current monthly income. In deciding whether a case is abusive, the court must also consider whether the case was filed in bad faith or whether the "totality of the circumstances" demonstrates abuse. Debtors failing this "means test" would be permitted to file for bankruptcy under Chapter 13. (Chapter 7 allows people to liquidate their assets quickly and discharge most unsecured debts, such as those to credit card issuers. Chapter 13 requires a repayment plan.)

- Make nondischargeable any debt, including credit card debt, incurred:
  - to pay an otherwise non-dischargeable debt with the intent to discharge the newly acquired debt; and
  - to pay non-dischargeable debts, without regard to intent, if incurred within 70 days of bankruptcy filing.
- Make debtors repay more debt under Chapter 13 filings by: (1) increasing from three years to five years the minimum term a debtor whose monthly income is greater than the national median monthly income for a family of equal or lesser size has to pay off debts; and (2) eliminating the "superdischarge" of certain debts (i.e., the discharge of several types of debt, including those for fraud and intentional injuries) that are not discharged in Chapter 7.

Discouraging Abuse of the Bankruptcy System. S. 625 would:

- Bar debtors from filing a petition unless they have sought the assistance of credit counseling during the 180-day period prior to the filing of the petition.
- Provide a 30-day limit on the application of the automatic stay against collection actions for a bankruptcy petition filed within one year of a previous petition.
- Bar the "stripping" of liens (reducing a creditors claim to the value of the collateral, regardless of the remaining debt owed) for an automobile acquired by the debtor within five years of filing the bankruptcy petition, and for other property acquired within six months.
- Change the non-dischargeability rules for luxury goods by: (1) defining a "luxury good or service" to exclude those "reasonably necessary for the support or maintenance of the debtor or a dependent of the debtor" and (2) establishing a cap on dischargeable luxury goods or services of $250 incurred within 90 days, or cash advances of $750 incurred within 70 days, of filing the petition. Current law limits cash advances to $1075 during the preceding 60-day period.
- Permit the use of State exemptions, rather than Federal exemptions, only if the debtor has lived in the State for two years or more. This provision would prevent debtors from shielding sizable assets by moving to a State with more generous

exemptions just prior to filing for bankruptcy.

Consumer Protections. S. 625 would:

- Require creditors who seek reaffirmation of wholly unsecured consumer debt to provide a disclosure that the debtor is entitled to a hearing.

- Provide for new penalties against creditors who threaten to file motions to dismiss the bankruptcy petition with the intent of coercing the reaffirmation of a debt when they have no reasonable justification for such a motion.

- Establish domestic support obligation as the first priority for payment of unsecured debt (currently it is the seventh priority) and make domestic support obligations non-dischargeable.

Bankruptcy Procedures. S. 625 would:

- Establish new deadlines for several important events in consumer bankruptcy cases (e.g., changing from 40 days to 90 days the deadline for the first meeting of creditors in Chapter 7 cases).

- Require that consumer debtors receive information about debt counseling services and their options before filing bankruptcy. The form of the notice would be prescribed by the United States Trustee for the district and would contain a brief description of the bankruptcy chapters, the benefits and costs of each chapter, and services available from a credit counseling service approved by the United States Trustee for that district.

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

- Protect local property taxes, which generally provide the largest source of funds for public schools, from subordination to debts.

Business Bankruptcy Provisions. S. 625 would:

- Require a small business debtor to file periodic reports explaining: (i) its profitability; (ii) projected income and expenses; (iii) how prior projections compare with actuality; (iv) compliance with bankruptcy requirements; (v) whether taxes returns are timely filed; (vi) what taxes and other adminis-trative claims are in default and when remedied; and (vii) "other matters" needed in the creditors' and the public's interest.

- Require an ombudsman to be appointed in every chapter 7, 9, or 11 case involving a "health care business" to monitor the quality of patient care and provide status reports to the court every 60 days.

- Make permanent chapter 12 of the Bankruptcy Code, which, according to the Report of the National Bankruptcy Review Commission (NBRC), is "better suited to meet the particularized needs of family farmers in financial distress than other forms of bankruptcy relief, such as chapter 11 and chapter 13." H.R. 808, the " Family Farmer Bankruptcy Act Extension", which the President signed into law on March 30, 1999, extended the chapter 12 provisions until October 1, 1999.

Pay-As-You-Go Scoring

According to TCJSD (Thompson), S. 625 would affect direct spending or receipts. Therefore, it is subject to the pay-as-you-go requirement of the Omnibus Budget Reconciliation Act of 1990. OMB's preliminary estimate is that S. 625, as reported would have a net budget cost of $0 in 2000 and $9M for 2000-2004.

LEGISLATIVE REFERENCE DIVISION
November 8, 1999 - 9:37 AM

Message Copied To:______________________________

Eric P. Liu
11/08/99 05:05:10 PM

Record Type: Record

To: Anna Richter/OPD/EOP@EOP

cc:
Subject: Re: Bankrupcy (et al) SAP

---------------------- Forwarded by Eric P. Liu/OPD/EOP on 11/08/99 05:05 PM ---------------------------

Andy Rotherham
11/05/99 10:55:15 AM

Record Type: Record

To: Sarah Rosen Wartell/OPD/EOP@EOP

cc: Anna Richter/OPD/EOP@EOP, Bruce N. Reed/OPD/EOP@EOP, Eric P. Liu/OPD/EOP@EOP
Subject: Re: Bankrupcy (et al) SAP

It does need to include something on the education provision. You can wordsmith as to the procedural stuff but it should say something like,

"The Administration understands that an amendment will be offered to include the "Teacher Empowerment Act" as part of this legislation. When an almost identical version of the "Teacher Empowerment Act" passed the House this summer, the President's senior advisors recommended that he veto it should it reach his desk. The Administration's position on this legislation has not changed. The "Teacher Empowerment Act" would gut the class size reduction program that a bipartisan majority in Congress agreed to last year, would not target funds to the neediest students, and would undermine the federal commitment to help states and school districts provide quality professional development for teachers. This provision has nothing to do with the issues addressed in the underlying bankruptcy bill and its inclusion would make the bill unacceptable to the administration."