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What's Wrong with S. 256, Let Us Count the Ways ...

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The latest version of the bankruptcy bill, S.256, is now poised for consideration by the Senate. This is essentially the same bill that was last passed by the House in May, 2003 by a vote of 315 to 113 during the 108th Congress.[1] It is also identical to the Conference Report from the 107th Congress, except that it is stripped of the Schumer clinic violence amendment that had previously prevented the bill from passing in the Senate. The bill remains unbalanced and unfair, and is certain to wreak havoc within the bankruptcy system. In case you have forgotten just how bad this bill really is, here is a rundown of some of the key problems.

1. Subjects Debtors to a "Means Test" that Fails to Screen for Abuse and Instead Penalizes Honest Debtors by Imposing Additional Costs and Filing Burdens.

The bill amends Code § 707(b) by adopting a rigid formula to determine whether a debtor is presumed ineligible for a chapter 7 discharge.[2] Unlike the present system that screens for "substantial abuse" by comparing the debtor's actual living expenses to income, the means-test formula uses pre-determined budget amounts based on the Internal Revenue Service's National Standards and Local Standards.[3] For example, if the IRS Local Standard sets a debtor's monthly housing and utilities allowance at $756, this is the expense amount used in the means-test formula even if the debtor's actual rent and utilities are $950 per month.[4] Similarly, a debtor

[1] The bill retains a similar title (or misnomer): "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005."
[2] Section 102 of S.256.
[3] The IRS developed these standards as guidelines for its own debt collectors, subject to individual collector's exercise of discretion and consideration of exceptions.
[4] Although the IRS housing and utilities standard is a lump-sum amount that does not provide a breakdown between the separate housing and utilities components, § 102(a) of S.256 provides that a debtor can seek an additional allowance based on the actual expense for home energy costs if the debtor can demonstrate that such actual expenses are "reasonable and necessary." How the court will derive the housing allowance portion of the IRS standard once actual energy costs are used is an open question.

whose actual food bill is $350 per month because of a special diet prescribed by her doctor for health reasons will be limited to the IRS standard of $196 per month.[5]

On the equation's income side, the formula uses the debtor's average prior 6 months' income to project what could be paid creditors under a chapter 13 plan.[6] This "current monthly income" is used even if some or all of the income counted during the six-month test period is no longer available because of job loss, temporary disability or divorce. Trying to fix this problem requires the debtor to incur unnecessary litigation costs in petitioning the court to ignore the income definition.

As a strong disincentive for debtors' attorneys to challenge application of the means test, the bill also provides that monetary sanctions, and attorney's fees and costs to the trustee, shall be imposed on debtors' counsel under a Rule 9011 standard if a trustee's dismissal or conversion motion is granted.[7]

Ironically, since the formula compares presumed income and expenses with the amount of unsecured debts, debtors who have large amounts of credit card and other unsecured debt are more likely to flunk the means test and will be permitted to obtain a chapter 7 discharge.[8] In addition, since the debtor is allowed to deduct on the expense side the *actual* amounts payable on priority and secured debts (including for example the monthly installment payment on a luxury auto), and *actual* amounts for "Other Necessary Expenses" listed in the IRS collections standards manual,[9] the so-called "high-rollers" that proponents claim the bill was aimed at will likely escape scrutiny under the means test, particularly since they have the means to litigate application of the presumption.

As another example that the bill sponsors are not interested in curbing real abuse, the bill does not change the current limitation in § 707(b) that makes the abuse provisions apply only to debtors who have primarily *consumer* debts. Is there any sound reason in this post-Enron era to exclude from the means test or the general abuse provisions debtors with business debts, such as corporate executives?

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[5] Section 102(a) of S.256 provides that a debtor can seek an additional allowance for food and clothing of up to 5% if the debtor can demonstrate that this is "reasonable and necessary." In this example, petitioning the court would at best result in a mere additional $10 in the food allowance.

[6] Section 102(b) of S.256 amends § 101 of the Code to add a definition for "current monthly income."

[7] The bill contains many other provisions that negatively impact on attorneys who represent consumers in bankruptcy, including requirements that attorneys: certify the accuracy of factual allegations in the debtor's bankruptcy petition and schedules, under penalty of harsh court sanctions; certify the ability of the debtor to make payments under a reaffirmation agreement; and identify and disclose themselves as "debt relief agencies." The American bar Association has provided a detailed analysis of the problems with these provisions in a letter dated February 8, 2005, which is available at: http://www.abanet.org/poladv/priorities/brattyliabilitylettertosenjudcommelectronicfebruary2005.pdf.

[8] Under the means test, abuse is presumed if the debtor could pay in 60 months the sum of $6000 or 25% of non-priority, unsecured debts, whichever is greater, or the sum of $10,000 ($166.67 per month).

[9] These include items such as childcare, dependent care, taxes, health care, and life insurance.

Even if the debtor does not flunk the means test, the bill changes current law in several ways. It permits creditors and other parties in interest to file dismissal motions under the general abuse provisions in § 707(b) if the debtor's income exceeds the median income.[10] The bill replaces the phrase "a substantial abuse" in current § 707(b) with simply "an abuse." The bill also deletes the language in current § 707(b) which establishes a presumption in favor of granting a discharge to the debtor. This less strict standard will provide new opportunities for creditors to block a debtor's discharge, even for debtors below median income.

The bill will create much litigation on the front end of bankruptcy cases, with hearings on challenges to the application of the means-test presumption presumably deferred until after the meeting of creditors. While debtors with real ability to pay should make their best efforts to do so, the means test does a poor job of finding those debtors and increases costs for all other debtors.

2. Creates a "Safe Harbor" from the Means Test for Low-Income Debtors, But Still Subjects Them to Increased Costs and Filing Requirements, Including Credit Counseling and Education.

Debtors with incomes below the applicable median family income will not be subjected to the means test. The bill provides that the bankruptcy judge, trustee, or other parties in interest are prohibited from filing a motion seeking to apply the means test if the debtor's current monthly income multiplied by 12 is equal to or less than the highest median family income based on family size for the debtor's state as reported by the Bureau of the Census.[11]

For debtors below the median income, the court may still dismiss or, with the debtor's consent, convert the case to chapter 13 if the granting of the discharge would amount to an "abuse." Unlike debtors above the median income, this can only be done on the court's own motion or the motion of the trustee, not a creditor or other party in interest.

Though the means test does not apply to low-income debtors, they are not exempt from a whole host of new requirements that apply to all consumer debtors, such as credit counseling and education, tax return and other filings, and random audits.

Credit Counseling and Education

The bill will require all debtors in chapter 7 and chapter 13 cases, including low-income debtors, to obtain pre-bankruptcy credit counseling as a condition of filing eligibility and post-bankruptcy education as a condition for discharge.[12] Debtors will be required to file a certificate

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[10] Current law explicitly states that § 707(b) motions may not be granted "at the request or suggestion of any party in interest." The bill places the current § 707(b) provisions, with modifications, in a new subsection designated § 707(b)(1). The means test provisions would be codified in a new § 707(b)(2).
[11] Though the bill is not explicit, the Census Bureau's definition of a "household" will likely be applicable.
[12] Section 106(a) of S.256.

from an approved non-profit credit counseling agency stating that the debtor has been provided a "briefing" on credit counseling options and assistance in conducting a budget analysis during the 180-day period prior to the bankruptcy filing. If a debt repayment plan is prepared by the counseling agency, a copy must be filed with the court along with the certificate.

Forcing all debtors to obtain credit counseling, even those who are hopelessly insolvent and have no ability to form a repayment plan, will do little to increase the payment of consumer debt or reduce the number of bankruptcy filings. While the requirement may simply delay the inevitable in most cases, it could subject some debtors to the deceptive practices and excessive costs of certain low-quality credit counseling "mills" who would target consumers seeking bankruptcy relief. NCLC and the Consumer Federation of America have released reports on the credit counseling industry that describe these abuses.[13]

The bill also requires debtors to complete a personal financial management course.[14] Code sections 727(a) and 1328 are amended so that debtors who fail to complete the course will be denied a discharge.[15] Though well-designed and implemented educational programs could help some debtors avoid future financial problems, such programs do not currently exist (with a few notable exceptions),[16] and there is no reason to believe that quality programs will be created since the legislation provides no funding for such programs. In fact, most credit counseling agencies today have cut back significantly on education programs due to financial concerns.[17] While it would be far more sensible to delay this requirement's implementation until the United States Trustee's office completes a study on pilot test programs, the education requirements take effect immediately upon passage.[18]

The bill has a limited exception, permitting waiver of the pre-bankruptcy credit counseling requirement based on "exigent circumstances,"[19] and the bill specifies that the

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[13] *See Credit Counseling in Crisis: The Impact on Consumers of Funding Cuts, Higher Fees, and Aggressive New Market Entrants*, NCLC and CFA, April, 2003. The report is available on NCLC's website at: www.nclc.org/initiatives/content/creditcounselingreport.pdf. NCLC released an update to the original report entitled: *Credit Counseling in Crisis Update: Poor Compliance and Weak Enforcement Undermine Laws Governing Credit Counseling Agencies*, which is at: www.nclc.org/initiatives/credit_counseling/content/cc_enforcement.pdf.
[14] Section 106(b) of S.256.
[15] This provision will not apply if the debtor lives in a district where the United States Trustee's office has found that no adequate management course is available. A similar provision exists for the credit counseling requirement.
[16] For example, the Coalition for Consumer Bankruptcy Debtor Education is one of the few organizations offering quality debtor education. Information on this important project can be obtained at www.debtoreducation.org.
[17] Some of the reasons for this are outlined in NCLC's report.
[18] Section 105 of S.256 provides that the United States Trustee's office is to conduct an evaluation over a 18-month period of the effectiveness of the educational programs in six test districts.
[19] Exigent circumstances are not defined but presumably would include an emergency filing necessitated by an imminent home foreclosure or auto repossession. To obtain a waiver of the counseling requirement, the debtor will need to submit a certification with the bankruptcy filing describing the exigent circumstances and stating that the debtor requested but could not obtain credit counseling services within

counseling services may be provided by telephone or over the Internet. However, there are no similar exceptions for the post-bankruptcy education requirement. This is likely to prove a particular hardship for rural debtors, the homebound, and debtors who will lose wages or incur daycare costs to attend a required education program. There is also little provision made in the bill for families with limited financial resources to afford these programs in addition to their bankruptcy filing and counsel fees.[20]

The bill will most certainly impose a difficult burden on the United States Trustee's office to provide oversight over these agencies and protect debtors from consumer scams. Regretfully, some of the less reputable counseling agencies, particularly those that will not be approved by the United States Trustee's office to provide services, will still view the bill's requirements as a marketing opportunity and attempt to profit off debtors seeking bankruptcy relief.[21]

Tax Return Filings, Income Statements and Pay Stubs

Various provisions of the bill require that tax returns be filed with taxing authorities and the court.[22] In chapter 7 cases, the debtor must provide a tax return (or transcript) for the most recent tax period to the trustee at least seven days before the § 341 meeting. The debtor is also required to provide copies of the tax return to creditors when requested. In chapter 13 cases, the debtor must file before the § 341 meeting tax returns for the prior four years with taxing authorities if the debtor is required to file returns.

The debtor must also file copies of pay stubs or other evidence of payment from an employer for income received within 60 days of the bankruptcy filing. The debtor must prepare a statement listing the debtor's monthly net income, showing an itemization of how the amount was calculated and a statement that discloses any "reasonably anticipated" income and expenses for the one-year period following the bankruptcy filing. In chapter 13 cases, the debtor will be required to file an initial detailed statement of income and expenses based on the preceding tax year, and a similar statement for each year during the plan.[23] In chapter 7 cases, the debtor must prepare and file a statement as to the calculations under the means test (which is served on all creditors) even if the means test does not apply because the debtor is below the median family income.

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the five-day period following the request. The waiver will be granted if the court finds the exigent circumstances to be "satisfactory."

[20] Section 105 of S.256 adds a new Code section 111, which states that to be an approved credit counseling agency, the agency shall charge a "reasonable fee" and provide services to those unable to pay. It is unclear whether oversight of this provision would be available. It is also unclear that it applies to the post-bankruptcy education requirements.

[21] As NCLC's recent report suggests, the non-profit status of the agency is certainly no guarantee that the agency is reputable.

[22] Sections 315(b), 716 and 1228 of S.256.

[23] Section 315 of S.256.

Failure to provide copies or file these various documents, forms and tax returns will result in automatic dismissal of cases,[24] the denial of chapter 13 plan confirmation,[25] and the denial of discharge. [26]

The bill assigns to the Administrative Office of the United States Courts the difficult task of establishing procedures for safeguarding the confidentiality of the filed tax information. It is hard to imagine how the Administrative Office would ever be able to construct adequate privacy safeguards when the bill permits creditors and other interested parties to obtain tax returns and other documents containing some of the most sensitive information about debtors. The information and documents that would be filed or could be requested under the bill contain private personal information, such as Social Security numbers, names of children and dependents, bank account numbers, income and other tax information, dates of birth, market value of real property and other assets, alimony and support payments, and listings of expenses, purchases, medical treatment, and other personal spending habits. These documents include unique personal identifiers and information that is particularly susceptible to abuse. This information, if used improperly in an identity theft or predatory lending scheme, can plague debtors for years and prevent them from obtaining a fresh start. [27]

Audits

The bill provides for random audits of a significant number of debtors.[28] There will be a random selection process providing for the audit of at least 1 in every 250 cases and a targeted selection process for debtors whose schedules "reflect greater than average variances" from the local statistical norm.

No provision is made for the costs of audits, loss of wages to attend an audit, or the attorney fees that might be applicable to representation during an audit. How low-income debtors who have just scraped together enough money to pay fees for credit counseling, the bankruptcy filing fee, a financial management course, and representation for the initial bankruptcy filing will now find money to pay their attorney for representation in the audit remains a mystery.

To compound the matter, the bill's many new requirements imposed on the court system and the United States Trustee's office, and the cost of the audits themselves, will almost certainly

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[24] Section 316 of S.256. Section 315(b) also provides that the failure to provide a tax return (or transcript) under that section's requirements will result in dismissal unless the debtor demonstrates that the failure was due to circumstances beyond the debtor's control.
[25] Section 716 of S.256.
[26] Section 1228 of S.256.
[27] A survey sponsored by the Federal Trade Commission in 2003 suggests that incidents of identity theft are on the rise in the United States. The survey revealed that 12.7% of Americans reported to have been victimized by some form of identity theft in the previous five years, and that the total cost of this crime is estimated at $50 billion per year. Victims of identity theft spent on average 30 hours trying to resolve their problems (60 hours for cases involving credit card misuse). *See* http://www.ftc.gov/os/2003/09/synovatereport.pdf.
[28] Section 603 of S.256.

require an increase in the bankruptcy filing fee.[29] This will further limit access to the bankruptcy system for low-income debtors.

3. Requires Stricter Scrutiny of Low-Income Debtors' Expenses in Chapter 13 Than Higher Income Debtors and Makes Some Debtors Too Rich for Chapter 7 and Too Poor for Chapter 13.

The bill amends § 1325(b) of the Code by replacing the existing chapter 13 disposable-income test with the means test.[30] However, perhaps due to a drafting error, the means test is only applicable in chapter 13 cases for debtors whose income is above the median family income. This means that for higher income debtors, monthly budget payments on many secured debts, priority debts, and other expenses allowed under the means test will be deemed reasonable for chapter 13 plan confirmation. On the other hand, lower income debtors will need to prove that all of their expenses are reasonably necessary for the maintenance and support of the debtor and the debtor's family. This creates the absurd result that a trustee may not be able to challenge a higher-income debtor's mortgage payment on a vacation home under the means test, since it is an allowed expense for secured debt, but would have the ability to question the reasonableness of all expenditures of a low-income debtor.

The bill also leaves unanswered the fate of a debtor who initially flunks the means test, thereafter files or converts to a chapter 13, but then is unable to obtain plan confirmation or has the chapter 13 dismissed because of inability to make plan payments. For debtors who are just above the median income and struggling to make payments under a plan crafted with unrealistic budget amounts using the means test formula, this is not an unlikely outcome. Under existing law, the debtor would be permitted to convert back or refile a new chapter 7 case. A strict reading of the bill, however, would require a court to reinstate the means test thereby denying the debtor the opportunity to obtain a discharge. The debtor is effectively shut out of the bankruptcy system, unable to obtain relief under either chapter 13 or chapter 7.[31]

4. Erodes Bankruptcy's Fresh Start by Making More Debts Nondischargeable in Both Chapters 7 and 13.

The bill contains provisions that would expand the presumption of fraud related to nondischargeability of credit card debts.[32] Fraud would be presumed for debtors that incur $500 for luxury goods and services within 90 days or $750 in cash advances within 70 days before

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[29] The bill does not provide funding for the cost to the government for the audits, which some estimate could exceed $9 million per year.

[30] Section 102(h) of S.256.

[31] In the 106th Congress, an amendment proposed in conference by then-Judiciary Committee Chairman Henry Hyde would have clarified that a debtor found ineligible for chapter 7 bankruptcy relief under the means test, but who lacked the financial resources necessary to have a court approve a chapter 13 payment plan, would be allowed to refile for chapter 7.

[32] Section 310 of S.256.

bankruptcy.[33] These provisions will most heavily burden low-income debtors who do not have the financial resources to overcome the presumption and debtors with genuine financial emergencies who do not have the ability to plan the date for their filing to place purchases or cash advances outside the extended presumption period.[34]

The bill also eliminates the chapter 13 "superdischarge" for certain debts.[35] It will make debts incurred by fraud, as provided under current § 523(a)(2) and (a)(4), and unscheduled debts under current § 523(a)(3), nondischargeable in chapter 13 cases. It also creates a new type of chapter 13 nondischargeability for debts based on willful or malicious injury.[36] Another section of the bill makes certain tax debts nondischargeable in chapter 13.[37]

The new chapter 13 fraud exception will exacerbate current problems debtors face in chapter 7 cases with certain credit card companies and other creditors who file meritless claims of fraud hoping to strong-arm a reaffirmation agreement, knowing the debtor will want to avoid significant litigation costs to defend the action. Low-income families in chapter 13 cannot afford the defense costs in these nondischargeability cases when their income is fully committed to necessities, mortgage payments, and plan payments, putting further stress on the feasibility of chapter 13 plans. A finding of nondischargeability of a substantial credit card debt will almost certainly be the death knell of the chapter 13 case, particularly if the debtor is not permitted to amend the plan to provide for favored treatment of the nondischargeable debt based on § 1322(b)(1). Not surprisingly, the same bill that on the one hand pushes more debtors into chapter 13 at the same time makes it more difficult for them to stay in chapter 13.

5. Promotes Predatory Lending by Encouraging Creditors to Take Liens on Household Goods of Nominal Value.

Prior to the enactment of the Code in 1978, finance companies often made small loans at high interest rates that were secured by the borrower's household goods. Although the goods were of nominal value, the security interest was a valuable collection tool for the lender due to the leverage that came with the threat of repossession.[38] In enacting the Code, Congress

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[33] Under current law, § 523(a)(2)(c) provides that fraud is presumed for debts of $1075 for luxury goods and services incurred within 60 days or $1075 in cash advances incurred within 60 days before bankruptcy.

[34] Section 314 of the bill also contains a provision that would make non-dischargeable debts incurred to pay any non-federal taxes that would be non-dischargeable under § 523(a)(1).

[35] Section 314 of S.256.

[36] This discharge exception applies to an award of restitution or damages in a civil action based on willful or malicious injury by the debtor that causes personal injury or death to an individual. The injury need only be "willful *or* malicious," unlike the "willful *and* malicious" test under current § 523(a)(6).

[37] Section 707 of H.R. 975 provides that taxes currently covered by § 523(a)(1)(B) (unfiled or late filed taxes) and § 523(a)(1)(c) (fraudulently filed taxes) would be nondischargeable in chapter 13.

[38] In 1978, Congress expressed aversion to the leverage associated with improper valuations of personal property security interests. The Committee on the Judiciary stated:

> Most often in a consumer case, a secured creditor has a security interest in property that is virtually worthless to anyone but the debtor. The creditor obtains a security interest in all of the debtor's furniture, clothes, cooking utensils, and other personal effects. These items have little or no resale

recognized the true value of such liens and gave debtors the right to avoid non-purchase money liens on exempt "household goods" under § 522(f)(1)(B).

Current law does not define "household goods" for purposes of § 522(f) lien avoidance, though most courts consider that it includes certain basic items as clothing, furniture, and other personal property "kept in or around the home and used to facilitate the day to day living of the debtor and the debtor's dependents."[39]

Now Congress plans to turn back the clock and change the lien avoidance provisions in a way that encourages more predatory lending practices. The bill contains a very narrow definition of "household goods" that would be applicable under § 522(f) in all states in lien avoidance proceedings.[40] It expressly does not include any work of art (unless by or of the debtor or a relative of the debtor), no matter how small the value, and electronic equipment other than one television, one radio, one personal computer, and one VCR.[41] The bill includes some limited additional protection (added in the earlier Conference Report) by providing that other electronic equipment totaling $500 or less in the aggregate will be "household goods," but this probably will not deter lenders who rely upon inflated valuations of the goods.[42]

Non-purchase money liens on items excluded under the new definition will no longer be avoidable. Undoubtedly this will lead to more aggressive finance company policies of taking liens that have threat value in bankruptcy and more reaffirmations will inevitably result.

6. Creates New Creditor Opportunities for Reaffirmation Abuses by Weakening Current Debtor Protections and Giving Creditors Safe Harbor from Liability.

The bill contains amendments to current Code § 524 that purport to protect debtors from reaffirmation abuses by creditors.[43] Unfortunately, the changes will do far more harm than good. Since creditors will have substantially more leverage to obtain reaffirmations based on

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> value. They do, however, have a high replacement cost. The mere threat of repossession operates as pressure on the debtor to pay the secured creditor more than he would receive were he actually to repossess the goods.

H.R. Rep. No. 95-595, 95th Cong. 1st Sess. 124 (1977).

[39] *In re* McGreevy, 955 F.2d 957 (4th Cir. 1992). During the 106th Congress, the House bill contained a reasonable definition of household goods that reflects current caselaw: "'household goods' includes tangible personal property normally found in or around a residence, but does not include motorized vehicles used for transportation purposes." *See* H.R. 833, § 145.

[40] Section 313 of S.256.

[41] Like so many sections of the bill that were drafted years ago and have not been updated, this section still refers to a VCR even though many consumers have replaced this item with a DVD player. Of course, this reflects the problem of having a laundry list of items in a statutory provision.

[42] The bill also provides that "household goods" does not include more than $500 in antiques or $500 in jewelry (except wedding rings).

[43] Section 202 of S.256.

other bill provisions (discussed below), this weakening of current legal protections will have a devastating impact on the fresh start.

The bill will require that debtors be provided with a reaffirmation disclosure statement. This lengthy statement contains little in actual substantive or useful information. And for those disclosures that could be meaningful, such as the "annual percentage rate" and repayment schedule, creditors are given much latitude in how these terms are disclosed, making it virtually impossible to prove inaccuracies.[44] Even worse, despite the well-known abuses by department store creditors in coercing reaffirmations based on inflated values for secured household goods, the new disclosure form does not even require that the creditor to disclose the current value of the secured property.[45] The form only requires a listing of the items and "their original purchase price," or the "original amount of the loan" for a nonpurchase-money security interest. In addition, several of the disclosures, such as the "annual percentage rate," assume that the underlying credit contract will remain in effect upon reaffirmation.

By far, the most troublesome aspect of the reaffirmation provisions is the broad safe harbor afforded creditors. The bill provides that the new disclosure requirements and the current disclosures under § 524(c) are satisfied if the disclosures "are given in good faith." A creditor can even accept payments made under a non-compliant reaffirmation, either before or after the filing of the reaffirmation, as long as the creditor "believes in good faith" that the agreement is effective.[46] Of course, litigation costs are greatly multiplied whenever the debtor has to prove, as a condition of recovery, that the creditor acted in bad faith.

7. Undermines Debtors' Ability to Save Homes and Cars in Chapter 13.

Numerous provisions in the bill will make chapter 13 a much less viable option for debtors attempting to save their homes from foreclosure or cars from repossession. By greatly limiting debtors' ability to cramdown secured claims in bankruptcy to the value of the collateral, the bill will force debtors to direct more of their limited income to undersecured car loans and department store debts, making it more difficult for them to come up with the money currently being committed under plans to make mortgage payments. Since lower income debtors have tighter budgets, these debtors are likely to be the most seriously affected by the changes.

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[44] For example, creditors are permitted to disclose the repayment obligations with "reasonable specificity to the extent then known by the disclosing party."

[45] By comparison, the current model Reaffirmation Agreement issued by the Administrative Office of the U.S. Courts requires a disclosure for secured debts of the value of the collateral, the basis or source of the valuation, the current location and use of the collateral, and the expected future use of the collateral. Many courts mandate the use of this Agreement or impose similar required disclosures under local rules.

[46] While § 524(c) of the Code requires that a reaffirmation be made before discharge to be effective, no explicit time deadline is imposed under the Code or the Bankruptcy Rules for the filing of a reaffirmation. Arguably, a creditor accepting payments on an unfiled reaffirmation which it "believes in good faith" was filed by the debtor may be insulated from liability under this provision.

Cramdown Provisions

The bill provides that a claim based on a purchase money security interest in a motor vehicle acquired within 2 ½ years (910 days to be exact) of the bankruptcy filing cannot be crammed down.[47] Other secured debts will be protected from cramdown if any (non-vehicle) collateral is acquired within 1 year of filing. Since some department stores claim to take a security interest in everything purchased with their store card, their entire debts would be treated as secured under this provision if the debtor used the card at all within the 1-year period before filing.

Debtors confronted with the new anti-cramdown provisions might consider redemption under § 722 in a chapter 7 case as an alternative. However, the bill drafters sought to foreclose that option as well by amending § 506(a). The bill requires that the amount of an allowed claim secured by personal property shall be based on the "replacement value" of the collateral, "without deduction for costs of sale or marketing."[48] In addition, another section of the bill prohibits redemption in installments.[49]

Since the amendment to § 506(a) requiring retail value also applies to determinations of allowed secured claims in chapter 13, the ability to cramdown car loans will be further restricted even if the car was purchased more than 2 ½ years before filing (or 1 year before filing for other secured purchases).

Finally, in another provision that will certainly impact low-income debtors and the elderly, mobile home liens will not be subject to cramdown, whether or not the mobile home is attached to real property.[50] These liens will have the same protection available to other residential mortgages under § 1322(b)(2) of the Code. At the same time, the anti-modification provision in § 1322(b)(2) is expanded to preclude stripdown of home mortgages when there is any additional property conveyed with the principal residence.[51]

Ride-Through Provisions

The bill amends § 521(a) of the Code to make clear that the "fourth" option in chapter 7 cases authorized in some circuits, which involves the retention of secured property without reaffirmation by continuing payments, will no longer be permitted.[52] The amendment limits a debtor who wishes to retain personal property subject to a purchase money security interest to two options; the debtor must either enter into a reaffirmation agreement with the creditor or

[47] Section 306(b) of S.256.
[48] Section 327 of S.256. This section additionally provides that if the collateral is acquired for personal, family, or household purposes, the replacement value means the "price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined."
[49] Section 304(2) of S.256.
[50] Section 306(c)(1) of S.256. This section amends current § 101 by adding a definition for "debtor's principal residence."
[51] Section 306(c)(2) of S.256. This section amends current § 101 by adding a definition for "incidental property," which is referenced in the new definition for "debtor's principal residence."
[52] Section 304(1) of S.256.

redeem the property under § 722. Unlike current law, the bill also provides that the stay is automatically lifted without a hearing, and the secured property is no longer property of the estate, if the debtor does not carry out one of the two options within 45 days of the meeting of creditors.[53]

This treatment of secured debts is expanded in another provision of the bill. Debtors will be required to file a statement of intention under § 521(a)(2) in both chapter 7 and chapter 13 cases (and chapter 11 if the debtor is an individual) as to all personal property that is either security for a claim or that is subject to an unexpired lease.[54] Moreover, the automatic stay is terminated without a hearing (and the property is no longer property of the estate) if the debtor does not surrender or redeem the property, reaffirm the debt, or assume the unexpired lease within 30 days from the date first set for the meeting of creditors. The stay will not be lifted if the statement specifies that the debtor will reaffirm the debt and the creditor refuses to enter into a reaffirmation on the original contract terms.

Adequate Protection Provisions

The bill also requires debtors to make adequate protection payments to secured creditors prior to confirmation in chapter 13 cases, unless the court orders otherwise.[55] Proof that the adequate assurance payments are being made must be provided to the trustee. The debtor must also provide any lessor of personal property or the holder of any purchase money security interest in personal property with proof of insurance coverage within 60 days of the chapter 13 petition, and shall continue to provide such proof "for so long as the debtor retains possession of such property."

The combined effect of these provisions restricting cramdown, redemption and ride-through is certain; fewer debtors will be able to use chapter 13 to protect important assets and more debtors filing chapter 7 cases will be forced to enter into reaffirmation agreements. Both of these outcomes run completely counter to the stated goals of Congress in enacting the Bankruptcy Code in 1978. Sadly, debtors emerging from chapter 7 cases who are burdened with reaffirmation payments and new nondischargeable debts are not likely to keep up with essential obligations such as child support and housing expenses.

8. Drastically Reduces Fundamental Protections Afforded Debtors Under the Automatic Stay.

As mentioned above, numerous provisions of the bill eviscerate the fundamental protections provided debtors by the automatic stay. Many of these provisions result in the automatic lifting of the stay based on the debtor's noncompliance with technical procedural

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[53] The trustee can seek to avoid this by filing a motion during the 45-day period. The court must then determine at a hearing that the property is of "consequential value or benefit to the estate," order appropriate adequate protection and order the debtor to turn over possession of the property to the trustee.
[54] Section 305 of S.256. The requirement to file a statement of intention will apply to all secured debts, not just secured consumer debts as under current law.
[55] Section 309(c) of S.256.

requirements. The following describe a few additional provisions that can easily derail a debtor's bankruptcy.

Notice Provisions

The bill strikes the language in Code § 342(c) which currently protects a debtor from minor deficiencies in notices to creditors that do not affect the ability of the creditor to understand its rights. It creates a court registry system for creditors to record addresses at which they wish to receive correspondence.[56] In addition, if a creditor within 90 days of a voluntary petition sends a debtor at least two communications with the debtor's account number and an address at which it wishes to receive correspondence, the debtor must send any correspondence required under the Code to that address and must include the account number.

Creditors would be allowed to ignore notices they receive which are not sent to a preferred address. The bill states that if "effective" notice is not given, the creditor may ignore the automatic stay and turnover provisions, since creditors are given immunity from any monetary sanctions for stay violations that occur before proper notice is given. This provision thus extends opportunities for creditors to violate the bankruptcy laws with impunity, based upon minor irregularities in notice, even if the creditor has received actual notice. No other American legal system allows parties that have notice to act as if they did not.

Landlord-Tenant Provisions

If a landlord has a prepetition judgment for possession, the automatic stay is eliminated unless the debtor within 30 days of the petition deposits any rent that has come due with the clerk of the bankruptcy court and certifies that the monetary default that gave rise to the eviction judgment has been cured under state law.[57] If no prepetition judgment has entered, the bill provides for termination of the stay if the landlord certifies that termination of the rental agreement is sought based on "endangerment of such property or the illegal use of controlled substances on such property." The landlord must certify that either an eviction action ahs been filed on this basis or that the debtor has within 30 days of the landlord's certification "endangered property or illegally used or allowed to be used a controlled substance on the property." If debtor files a certification denying the charges within 15 days, the bankruptcy court must conduct a hearing within 10 days.

Debtors cannot make their best efforts to participate in the bankruptcy process, if immediately after they file, they lose their homes. Landlords under current law are permitted to proceed against tenants after a brief breathing spell, if the tenant fails to make payments. Moreover, a significant number of tenants currently use the bankruptcy process to cure their back rent obligations by full payment. The bill will contribute to homelessness by preventing debtors from using the bankruptcy system to get caught up

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[56] Section 315(a) of S.256.
[57] Section 311 of S.256.

on their obligations to their landlords. It will also burden the bankruptcy system with contested trials on state law landlord-tenant matters.