NLWJC - Kagan

DPC - Box 002 - Folder 013

Bankruptcy [1]

Bankruptcy

Kate P. Donovan
10/08/98 05:15:59 PM

Record Type: Record

To: See the distribution list at the bottom of this message

cc:
Subject: URGENT: CONFEREES LETTER ON HR 3150

NEC has asked that we clear the letter below on HR 3150 - Bankruptcy Reform Act of 1998 in order to be release early this evening. House Rules & Floor action is expected shortly. Position: **Senior Advisers would recommend veto.** Please provide comments/clearance as soon as possible. Thanks.

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

Dear Mr. Chairman:

I write to provide the Administration's views on the conference report to H.R. 3150, the Bankruptcy Reform Act of 1998.

The Senate worked on a bipartisan basis to produce a 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, impose a rigid rule that denies bankruptcy judges adequate discretion to decide whether the debtor has the capacity to repay successfully a portion of debts under Chapter 13. The bill would require a moderate income debtor to demonstrate that each monthly expense for housing, clothing, transportation, and food that exceeds a predetermined 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 does not impose 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 adequately 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 any debt that was incurred within 90 days of bankruptcy to pay nondischargeable debt and any debt resulting from certain cash advances. This, in effect, puts some debt owed to credit card companies in competition with social priorities like child support and alimony, taxes, and educational loans. All too often pressures from an aggressive creditor trying to collect a nondischargeable debt can keep a struggling debtor from making child support and alimony payments.

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.

Sincerely,

Jacob J. Lew
Director

Identical Letter Sent to The Honorable Orrin G. Hatch,
The Honorable Charles E. Grassley, The Honorable Jeff Sessions,
The Honorable Patrick J. Leahy, The Honorable Richard J. Durbin,
The Honorable Henry Hyde, The Honorable John Conyers,
The Honorable George W. Gekas, and The Honorable Jerrold Nadler

Message Sent To: ____________________

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

October 9, 1998

THE DIRECTOR

The Honorable Trent Lott
Majority Leader
United States Senate
Washington, D.C. 20510

Dear Mr. Leader:

As you know, the President supports responsible bankruptcy reform that is balanced, would reduce abuses of the bankruptcy system, and would require debtors and creditors alike to act responsibly. The Senate produced a bipartisan bill that meets the test. The Administration is disappointed that H.R. 3150, as agreed to by the Conference Committee, contains many flawed aspects of the House bill and fails the test of balance. If this version of the Conference Report 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, use a rigid 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 Conference Report 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 that 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.

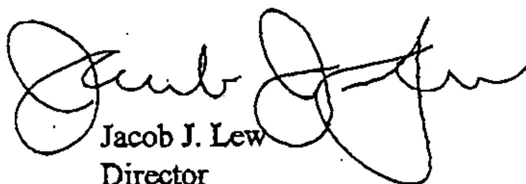
The Senate bill took laudable steps to enhance consumer protections from coercive and predatory behavior by creditors. The Conference Report, however, fails to limit adequately abusive creditor practices such as coercive affirmations and violations of the automatic stay, and rolls back consumer protections. The Conference Report also would deny consumers an effective means for remedying the harm from such practices -- class actions -- and, as to violations of the automatic stay, eliminate the current authorization for punitive damages against creditors for intentional violations of borrower rights.

Finally, the Conference Report includes provisions from the House bill that would render nondischargeable credit card debts that could compete with child support and alimony payments after a debtor has obtained a bankruptcy discharge. Specifically, the Conference Report would make nondischargeable any debt that was incurred within 90 days of bankruptcy to pay nondischargeable debt and for certain cash advances. This, in effect, puts debt owed to credit

card companies in competition with social priorities like child support and alimony, taxes, and educational loans. All too often, pressures from an aggressive creditor trying to collect a nondischargeable debt can keep a struggling debtor from making child support and alimony payments.

The overwhelming vote on the Senate floor for the bipartisan, balanced legislation that chamber 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. We stand ready to work with you and your colleagues to produce a Conference Report that would meet our concerns and the President could sign.

Sincerely,



Jacob J. Lew
Director

Identical Letter Sent to The Honorable Newt Gingrich,
The Honorable Thomas A. Daschle, and The Honorable Richard A. Gephardt

Bankruptcy

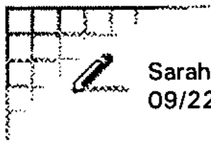
Cynthia A. Rice 09/23/98 01:56:29 PM

Record Type: Record

To: Elena Kagan/OPD/EOP, Laura Emmett/WHO/EOP

cc:
Subject: Elena left me voice mail asking if I'd added DPC to the bankruptcy memo

Yes I had. Here's the latest as of last night showing DPC agreeing with First Lady's office, etc.
---------------------- Forwarded by Cynthia A. Rice/OPD/EOP on 09/23/98 01:56 PM ---------------------------



Sarah Rosen
09/22/98 07:04:48 PM

Record Type: Record

To: See the distribution list at the bottom of this message

cc:
Subject: REVISED (AGAIN) BANKRUPTCY MEMO

This time we tried to eliminate discussion of that about which we agree and crystalize the disagreement between the parties. I think this is clearer and crisper. Thanks to Rob and Joe, I eliminated many extra words and now hang over the 3 page limit I got from Staff Secretary by only a paragraph. Any help to eliminate a few more lines would be appreciated.

Treasury -- Note that on your last paragraph, re how shifting to chapter 13 helps child support and alimony payment, HHS asked us to qualify that to be clear that it only helps IF we move the right people. IF they fail in chapter 13, then go back to 7, there are fewer assets and more, not less, to pay the kids.

This draft is going to Gene tonight. Final comments due at 10:00 tomorrow morning. We expect the final vote on passage tomorrow afternoon.

bankpotu.92

Message Sent To:

September 22, 1998 -- DRAFT

MEMORANDUM FOR THE PRESIDENT

FROM: **GENE SPERLING**

RE: **BANKRUPTCY REFORM LEGISLATION**

This memorandum seeks your guidance on whether we should take a very firm stance regarding the upcoming bankruptcy conference, threatening a veto if many of our conditions are not met, or whether we should be more willing to accept a bill meeting some of our goals and offering no harm to child support and alimony but without key aspects of the administration proposal.

Background

In June, you approved an Administration bankruptcy reform proposal. Today, the Senate passed, ___ - ___, a bankruptcy bill that reflects almost all the major elements of our proposal. While further improvements could be made, the Senate bill reflects a significant step toward balanced bankruptcy reform, dealing with abuses by both debtors and creditors.

The House bill has some desirable features too, but overall is far more problematic. That bill, which passed by a veto-proof majority over the Administration's strong opposition, uses a rigid formula to exclude certain debtors from Chapter 7's full discharge of unsecured debt, creates new nondischargeable debts that will compete with child support and alimony post-bankruptcy, and addresses perceived abuses by debtors but not by creditors.

Administration Proposal

The key aspects of our proposal, incorporated into the Senate bill, are:

(1) ***A Discretionary and More Targeted "Means Test"*** -- a discretionary approach to, and higher thresholds for, shifting borrowers from Chapter 7 to Chapter 13, instead of the House's rigid, arbitrary approach to determining whether a debtor can use Chapter 7;

(2) ***Elimination of New, Nondischargeable Debts*** -- eliminate new provisions that could pit, post-bankruptcy, credit card debt against child support, alimony, educational loans, and taxes, except for debt incurred with an intent to defraud;

(3) ***Balanced Reforms Affecting Creditors, as well as Debtors*** -- include balanced provisions that ask both debtors and creditors to behave more responsibly, including:
   (a) adequate protection against coercive reaffirmations; and

(b) disclosure requirements to ensure that consumers get the information that they need to manage their budgets.

Prospects for Conference

Work on compromising the two bills will begin immediately. The most likely outcome is a bill between the House and Senate approaches, with key Administration provisions watered down or omitted. Senator Grassley will fight hard to preserve the Senate approach, but Chairman Hatch expects the Senate approach to be compromised in conference. House Republicans have said that they will not compromise on key issues with the Senate.

On the other hand, the legislative calendar works in our favor. A more extreme approach in conference risks trouble on the Senate floor and a direct or pocket veto from you. Some Democratic Senators supported the Senate bill because of its balance and moderation. In the face of your strong opposition, the Senate [could, but is not certain to,] override your veto of a House-like final bill. [NEED TO SEE FINAL VOTE ON PASSAGE BEFORE DECIDE ON VIEW HERE.]

At best, conference will produce the minimum the Republicans think they need to give in order to get your signature. At worst, the conference will stick largely with the House approach, as Republicans may not believe you would veto a bill with such strong bipartisan support or may believe a veto could be overridden. Legislative Affairs recommends a clear message about what you would sign and what you would veto, if we hope to have any influence over the conference.

Staff have agreed on a letter to conferees laying out our position, but the language disguises a core disagreement on the bottom line. A clearer message could be sent with your guidance.

OPTION 1: INSIST ON INCLUSION OF THE ADMINISTRATION'S MODERATING AND BALANCED PROPOSALS, AS IN THE SENATE BILL.

Proponents: NEC, OLA, CoS (Echaveste), OVP, OMB, WH Counsel, DPC, OFL, OPL (Women's Office), Commerce, OTS, USDA and DoJ.[1]

The majority of your advisors will recommend that you veto a bill that deviates substantially from the Senate bill -- i.e., that: (1) retains the arbitrary House "means test" instead of the more flexible Senate approach; (2) creates categories of nondischargeable debt that compete with child support, alimony, educational loans, or taxes; or (3) fails to include some balance in the form of enhanced disclosures and consumer protections.

---

[1] Education prefers this approach, but would not recommend a veto unless an issue within their jurisdiction is implicated -- specifically, unless new nondischargeable debts are created that compete with educational loans.

These advisors feel strongly that we should not sanction a rigid "means test" that does not adequately consider the unique circumstances of individual debtors. Any test that excludes from Chapter 7 those able to repay significantly changes our bankruptcy system. We should be cautious in that change, lest we deny access to bankruptcy to those who need it most. We have offered an alternative between the House and Senate view that we could accept.

We all know that you will not accept any provisions that create new nondischargeable debts to compete with child support and alimony. But these advisors feel that, even if child support and alimony are untouched, no sufficient case has been made that certain credit card debt should be given the same protection that we give to educational loans or taxes, for example.

Finally, these advisors believe you must insist on balance -- curbing abuse by creditors as well as debtors. We are seeing more competition and dramatic changes in how creditors grant credit. While beneficial for some, these changes increase the number of consumers who can get in over their heads and dictate that we improve disclosures and enhance protections against coercion, especially if we are going to foreclose access to a "fresh start" for some who make a mistake.

OPTION 2: ACCEPT, IF NECESSARY, LESS IDEAL COMPROMISE AS AN IMPROVEMENT OVER THE STATUS QUO.

Proponents: Treasury and CEA.

Treasury and CEA believe that bankruptcy reform short of some Administration goals -- the likely outcome -- would still markedly improve the current system. While they would not support signing the House bill in current form, they do believe you should sign a bill with any reasonable compromise between the House and Senate approaches, if it meets our goals for the protection of child support and alimony payments.

Treasury and CEA emphasize that the House means-test formula would affect only 10% of filers, all with above-median income. Currently, these debtors escape their obligations, even though many likely can repay at least part of what they owe. Reducing their debt charge-offs would lower the cost of credit for all consumers -- a particular benefit for lower- and middle-income Americans who depend on consumer credit for significant household purchases.

Finally, Treasury and CEA argue that any compromise bill will likely improve payment of child support and alimony (provided that it creates no new post-bankruptcy obligations competing with these payments). Under the bill, more debtors will enter Chapter 13 court-supervised repayment plans, where child support and alimony receive first priority, and court supervision and other authorities make payment of these obligations more likely, provided that the means test used shifts the right people to Chapter 13.

Decision

While we seek no final judgement now regarding the bill to be produced by the conference, your response to this memorandum will allow staff to negotiate with a clear sense of your objectives.

OPTION 1 -- INSIST ON INCLUSION OF SENATE BILL PROVISIONS _________

OPTION 2 -- ACCEPT, IF NECESSARY, LESS IDEAL COMPROMISE ___________

LET'S DISCUSS __________

Bankruptcy

Cynthia A. Rice 09/21/98 07:08:06 PM

Record Type: Record

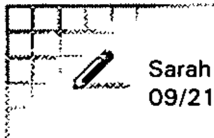
To: Laura Emmett/WHO/EOP

cc:
Subject: NEC wants to know whether DPC wants to be listed in this memo

as recommending for the bankruptcy bill conference a "hold firm for moderation and balance" or "accept, if necessary, less ideal reform as an improvement over the status quo" position (see page 3-4).

I plan to raise this at the team leaders meeting, but here's a copy in case Elena wants to review afterward.

---------------------- Forwarded by Cynthia A. Rice/OPD/EOP on 09/21/98 06:59 PM ---------------------------



Sarah Rosen
09/21/98 06:07:04 PM

Record Type: Record

To: Sarah Rosen/OPD/EOP

cc: See the distribution list at the bottom of this message
Subject: New Version of Bankruptcy Memo

Treasury and CEA decided that they support the language of the conferees letter. However, their real difference with the group is on the bottom line -- they want POTUS to sign whatever reasonable compromise emerges, as better than the status quo, while others think we should fight for moderation and balance. As a result, the memo has been recast (and unfortunately grew by a page). Please help me to prune it down again. Comments due by 10:00 am on Tuesday. Thanks.

bankpotu.92

Message Copied To:

September 22, 1998 -- DRAFT

MEMORANDUM FOR THE PRESIDENT

FROM: **GENE SPERLING**

RE: **BANKRUPTCY REFORM LEGISLATION**

In June, you approved an Administration bankruptcy reform proposal. We shared that proposal with key Senators and were successful in influencing the Senate bill. Today, the Senate passed, by a vote of ___ - ___, a bankruptcy bill that reflects almost all of the major elements of the Administration's proposal. While further improvements could be made, the Senate bill reflects a significant step in the direction of balanced bankruptcy reform.

The House bill is far more problematic. That bill, which passed by a veto-proof majority over the Administration's strong opposition, uses a rigid formula to decide who should be denied use of Chapter 7's full and immediate discharge of unsecured debt, creates new categories of nondischargeable debt that will compete with child support and alimony post-bankruptcy, and is heavily slanted to ending perceived abuse by debtors with no effort to end abuse by creditors.

Your advisors concur that:

(1) our goal is legislation that includes the important elements of the Administration proposal now in the Senate bill;
(2) the House bill, in its current form, is unacceptable; and
(3) we should send a strong signal to the conferees in order to increase our leverage.

Your advisors disagree, however, about the bottom line. It is likely that conference will produce a bill somewhere between the House and Senate bills. Many of your advisors will recommend that you veto a bill without the moderation and balance of the Senate bill; Treasury and CEA, however, will recommend that you sign a bill, even if it falls short of our goals, because they believe the reforms still represent a marked improvement over the current system. We seek guidance from you on this issue, so that we can best reflect your views in conference negotiations.

Background

Consumer bankruptcies continue to rise sharply despite strong economic conditions. Although there is much debate about the cause of the rise, there is evidence that both debtors and creditors abuse the current system to some degree. Regardless of who is to blame, higher levels of debt charge-offs raise the cost of credit for everyone.

Both bills contain desirable provisions that are not the subject of this memorandum, 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.

Prospects for Conference

Work on compromising the two bills will begin immediately. We expect Senator Grassley to fight hard to preserve the Senate approach. Senator Hatch, however, has been clear that he expects the Senate approach to be compromised in conference. House Republicans have stated that their intent is not to compromise significantly with the Senate.

On the other hand, the legislative calendar works in our favor. A more extreme approach in conference risks trouble on the Senate floor and a direct or pocket veto from you. Some Democratic Senators supported the Senate bill because of its balance and moderation. In the face of your strong opposition, the Senate [is not certain to/ is not likely to] override your veto of a House-like final bill. [NEED TO SEE FINAL VOTE ON PASSAGE BEFORE DECIDE ON VIEW HERE.] Of course, some Republicans may relish the prospect of a veto, eager only for the campaign issue.

Legislative Affairs recommends that we send a clear message about what you would sign and what you would veto, if we hope to have any influence over the outcome of conference. The best we can expect to get from conference is the minimum the Republicans think they need to give in order to get your signature. However, making our position clear is no guarantee that the conference will not favor the House bill approach, as Republicans may not believe you would veto a bill in the face of such strong bipartisan support or may believe a veto could be overridden. The most likely outcome is a bill somewhere between the House and Senate approaches, with watered down versions of key Administration provisions.

Message to Conferees

Your advisors propose that we send a letter to conferees that says:

(1) You would veto the House bill in its current form.

(2) You strongly believe that bankruptcy reform should enhance, and certainly must protect, the collection of debtors' child support and alimony obligations.

(3) You will not sign a bill if it includes:
  (a) a rigid, arbitrary approach to determining whether it is appropriate for a debtor to use Chapter 7; and

(b) new, nondischargeable debts that could inappropriately put credit card debt in competition post-bankruptcy with child support, alimony, and other societal priorities like educational loans and taxes.

(4) You believe that the reforms incorporated in the Senate bill are **essential,** including:
   (a) a discretionary approach to, and higher thresholds for, shifting borrowers from Chapter 7 to Chapter 13; and
   (b) limitations on the new categories of nondischargeable debt so that they only cover debt that was incurred with an intent to defraud.

(5) To gain your signature, a bankruptcy reform bill **must** contain balanced provisions that ask both debtors and creditors to behave more responsibly, including:
   (a) adequate protection against coercive reaffirmations; and
   (b) disclosure requirements to ensure that consumers get the information that they need to manage their budgets.

This approach leaves the Administration some flexibility to negotiate an acceptable package. It would preclude you, however, from signing a bill that uses the strict means-test approach to Chapter 7 that is contained in the House bill.

Negotiations Bottom Line -- Two Views

Hold Firm for Moderation and Balance

It is unlikely that we will be presented with a bill without any aspects of the Administration's proposal; instead, we can anticipate some watered-down provisions so that the Republicans can say that they have addressed our concerns. Perhaps they will do so sufficiently. If not, the majority of your advisors (NEC, Leg Affairs, CoS (Echaveste), OPL -- Women's Office, OVP, OMB, WH Counsel, Office of the First Lady, Commerce, Office of Thrift Supervision, and DoJ) will recommend that you veto a bill that fails in significant ways to meet the test in the conferees letter -- i.e., if it does not include in some reasonable form the reforms we declared "essential" and the balancing provisions we said "must" be included. (See (4) and (5) above.)

These advisors feel strongly that:

(1) We should not sanction use of a rigid "means test" that does not take into account the unique circumstances of individual debtors. The use of any test to exclude from Chapter 7 those with the capacity to repay is a significant change in our bankruptcy system. We should err on the side of caution when implementing that change, so we do not inadvertently deny access to bankruptcy to those who need it most.

(2) We must insist on balance -- creditors as well as debtors should be expected to act responsibly. We have recently seen dramatic changes in how credit issuers decide to grant credit -- broadening the spectrum of consumers who have a chance to get in over their heads. These changes make it imperative that we improve the information disclosed and enhance protections against coercion, especially if we are going to limit access to bankruptcy's "fresh start" for those who make a mistake.

[need to confirm positions of DPC, HHS, DoEd, USDA, CPSC.]

Accept, if necessary, less ideal reform as an improvement over the status quo.

On the other hand, Treasury and CEA believe that bankruptcy reform that falls short of some of the Administration's goals -- which the conference bill almost certainly will do -- would still represent a marked improvement over the current sustem. Thus, they believe that you should sign a bill that makes any reasonable compromise between the House and Senate approaches, and that meets our goals for the protection of child support and alimony payments.

Treasury and CEA emphasize that, even under the House approach, only 10% of filers would be affected by the means-test formula, all with above-median income. Under the current system, these debtors escape their obligations entirely, even though many are likely to have the ability to repay at least part of what they owe. Reducing their debt charge-offs would lower the cost of credit for all consumers -- a cost that is particularly important for lower- and middle-income Americans who depend on consumer credit for significant house hold purchases.

Finally, Treasury and CEA argue that any compromise bill is likely to improve payment of child support and alimony (provided that it creates no new post-bankruptcy obligations in ocmpetition with these payments). Under the bill, more debtors will enter Chapter 13 court-supervised repayment plans where child support and alimony receive first priority and court supervision and other authorities make child support and alimony payment more likely.

<u>Decision</u>

While no guidance you give us now will bind you in considering any bill produced by the conference, the guidance will allow staff to negotiate with a clearer sense of your objectives.

HOLD FIRM FOR MODERATION AND BALANCE ________

ACCEPT A BILL (IF NO HARM TO CHILD SUPPORT AND ALIMONY) AS AN IMPROVEMENT OVER THE STATUS QUO _________

LET'S DISCUSS _________

Bankruptcy

The Administration supports bankruptcy reform that asks responsibility of debtors and creditors alike. Debtors who genuinely have the ability to repay a portion of their debts should remain responsible for those debts. But creditors must also be responsible in their treatment of debtors, recognizing the inherent inequality of information and bargaining power that the two possess.

As initially reported from committee, S. 1301 focused primarily on purported debtor abuse, with little to curtail abuses by creditors. However, if changes incorporated in the managers' package of amendments are adopted, the Senate bill will take significant steps to address abusive practices by both debtors and creditors. Essential changes include new disclosure requirements to ensure that credit card companies provide consumers with the information about their accounts that they need to manage their budgets and procedural protections to avoid inappropriate and unwise reaffirmations of unsecured and certain secured consumer debts. We particularly appreciate modifications made to the nondischargeability provisions in the bill so that the bill no longer inappropriately puts credit card debt in competition with child support, alimony, and other societal priorities like educational loans and taxes.

The Administration also prefers the discretionary approach to limiting access to Chapter 7 used in S. 1301 over the rigid and arbitrary approach in the House bill. We appreciate changes made by the Senate bill to ensure that those debtors denied access to Chapter 7 under Section 707(b) of the Bankruptcy Code are those that have a strong likelihood of success under a Chapter 13 plan.

More can and should be done to produce a truly balanced bill. We must address the potentially coercive effect of allowing creditors to bring 707(b) motions for any reason, improve consumer understanding of the effect of granting security interests, and ensure that the protections against coercive reaffirmations are effective.

The Administration would support passage of S. 1301, if it is further amended in conference to improve the balance between reforms targeting debtors and reforms targeting creditors, and if the essential reforms incorporated by the managers' package of amendments are preserved.

The Administration also supports financial contract netting provisions in the bill that are important to reducing systematic risk in our financial markets.

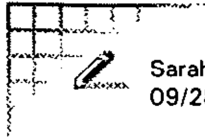
Finally, the Senate will vote on an amendment to raise wages of 12 million Americans and help ensure that parents who work hard and play by the rules do not have to raise their children in poverty. Two years ago, the President signed into law a similar moderate increase in the minimum wage. The results of that action are clear: it raised wages and did not cost jobs. Now we must continue to take actions to ensure that <u>all</u> Americans are benefitting from our prospering economy. That is why the Administration strongly supports raising the minimum wage by $1 over two years.

*****

Message Sent To:

Michelle Peterson/WHO/EOP
Robert N. Weiner/WHO/EOP
Roger S. Ballentine/WHO/EOP
Maureen T. Shea/WHO/EOP
Rebecca M. Blank/CEA/EOP
Elena Kagan/OPD/EOP
Douglas W. Elmendorf/CEA/EOP
Maria Echaveste/WHO/EOP
Sarah Rosen/OPD/EOP
Jonathan Orszag/OPD/EOP
Nicole R. Rabner/WHO/EOP
Joseph J. Minarik/OMB/EOP
Emil E. Parker/OPD/EOP
Jennifer L. Klein/OPD/EOP
John E. Thompson/OMB/EOP
Edward A. Brigham/OMB/EOP
Alice Veenstra/OMB/EOP
Courtney B. Timberlake/OMB/EOP
Mark A. Weatherly/OMB/EOP
Wayne Upshaw/OMB/EOP
Thomas P. Stack/OMB/EOP
Ellen J. Balis/OMB/EOP
Pamula L. Simms/OMB/EOP
Francis S. Redburn/OMB/EOP
John S. Radzikowski/OMB/EOP
Edwin Lau/OMB/EOP
Larry R. Matlack/OMB/EOP
Debra J. Bond/OMB/EOP
Joshua H. Raymond/OMB/EOP
Gary L. Bennethum/OMB/EOP
Toni S. Hustead/OMB/EOP
Janet E. Irwin/OMB/EOP

Bankruptcy



Sarah Rosen
09/28/98 12:30:35 PM

Record Type: Record

To: Ronald E. Jones/OMB/EOP

cc: See the distribution list at the bottom of this message
Subject: MINOR CHANGES BELOW -- SORRY I DIDN"T BLACKLINE -- BOLD CHANGED AREAS

September 28, 1998 -- DRAFT

Dear _____:

I write to share the Administration's views on H.R. 3150 and S. 1301 -- the two bankruptcy reform bills before the conference committee.

The President shares the Congress' concern about the sharp increase in consumer bankruptcy filings -- an especially puzzling increase in the face of our extraordinarily strong economy. The President **believes that bankruptcy reform should be** both balanced and moderate -- addressing the abuses of **creditors as well as debtors**, making prudent and well conceived improvements to our Bankrutpcy system, and protecting and enhancing the collection of debtors' child support and alimony in the context of bankruptcy. There is evidence of abuse by both debtors and creditors, but many other factors also may be involved in the large number of bankruptcies. We should, **therefore,** avoid a bill that takes indiscriminate aim at debtors and fails to address some troubling practices of creditors.

The extraordinary bipartisan support for the Senate bill was a unified endorsement of balance and moderation. Unfortunately, the House bill fails to meet this standard. If the House bill were sent to the President, his senior advisors would recommend that he veto the bill.

The Administration cannot support a bill that includes a rigid and arbitrary approach to determining whether a debtor can use Chapter 7 or must establish a repayment plan under Chapter 13. We should deny access to Chapter 7 only to those who genuinely have the capacity to repay a portion of the debts successfully under a Chapter 13 plan. Thus, bankruptcy courts must have discretion to consider the specific circumstances of a debtor in bankruptcy, and the thresholds they consider should be high enough to ensure that only those with a strong likelihood of success are affected. If we deny access to Chapter 7 to the wrong debtors, and those debtors fail to complete required repayment plans, they will return to Chapter 7 with a diminished ability to repay their nondischarged debt -- including child

support and alimony.

The Administration **agrees** that a creditor should be permitted to bring a motion under Section 707(b) to ask the court to determine whether a debtor has the capacity to repay, provided that protections against coercive reaffirmations are included in the bill. However, the Administration cannot support a bill that **invites unrestricted and abusive** creditor motions based on traditional 707(b) allegations of abuse, which may be more subjective than a test for one's capacity to repay. Allowing these motions could make more unequal the balance of power and information between creditor and debtor, especially for lower income debtors who would have the least power to defend themselves against unjustified motions.

The Administration also cannot support legislation that creates new, nondischargeable debts that could pit, post-bankruptcy, credit card debt against child support, alimony, educational loans, and taxes. For debt incurred to pay nondischargeable debt, the Senate bill appropriately makes the debt nondischargeable only when a court finds that the debtor intended to avoid the debt through bankruptcy. For debt incurred within 90 days of bankruptcy, the Senate bill makes the debt nondischargeable only if there is more than $400 of debt to a single creditor for goods or services "not reasonably necessary for the support of the debtor or a dependent child." Here the Senate bill falls short too. **Any provision should allow for all debt, without any cap, for goods or services reasonably acquired to support the debtor's household, not just dependent children. There is no possible reason to exclude expenses for elderly or other dependents.**

Finally, the Administration cannot support legislation that does not curb abuse by creditors as well as debtors. Credit card companies must give consumers more and better information so that they can understand and better manage their debts. Similarly, we must protect debtors against predatory creditor tactics to coerce inappropriate and unwise reaffirmations of unsecured debt and secured debts for personalty that are likely to have little resale value.

This letter sets forth our views on some of the central consumer bankruptcy issues in these bills. **There are other concerns about the many provisions in these bills which we will share as quickly as possible.**

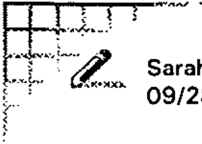
We look forward to working with the Congress to enact moderate and balanced bankruptcy reform legislation.

Sincerely,

Jack Lew

Message Copied To: ______________________________

Bankruptcy



Sarah Rosen
09/28/98 12:47:43 PM

Record Type: Record

To: Sarah Rosen/OPD/EOP

cc: See the distribution list at the bottom of this message

Subject: Re: MINOR CHANGES BELOW -- SORRY I DIDN"T BLACKLINE -- BOLD CHANGED AREAS

P.S. Please let me know if anyone would object if we added a sentence that said:

Finally, the Administration urges inclusion, in the final legislation, of the Senate-passed cap on state homestead exemptions to eliminate the opportunity for the rare, but most visible, cases of debtor abuse.

Message Copied To:

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Robert N. Weiner/WHO/EOP
Roger S. Ballentine/WHO/EOP
Maureen T. Shea/WHO/EOP
Rebecca M. Blank/CEA/EOP
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WR - fathers
(or is this
Family-fathers?)

Welfare Reform Q&A on MDRC Parents' Fair Share Demo
September 29, 1998

Q: Are you disappointed with the report released today showing that programs to increase earnings and child support for low-income fathers don't have any impact?

A: While these early results are disappointing, we believe it is important to learn from the results of the Parents' Fair Share demonstration about how to strengthen programs to help poor fathers increase their employment and their child support payments. We will continue working closely with key federal, state and local partners and the policy community to try to find effective approaches. Many states are using their Welfare-to-Work funds to serve the fathers of children on welfare and we want to make sure we learn as much as we can from these initiatives around the country. It is worth noting that the demonstration program was largely implemented before the new welfare reform law, including tougher child support provisions, was fully implemented.

Bankruptcy

...d Games

...s Bankruptcies Surge, Creditors Lobby Hard To Get Tougher Laws

But Whether Many People Shirk Bills They Can Pay Remains Open to Debate

Changing the Lenders' Image

A1

By JACOB M. SCHLESINGER
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON—It has become conventional wisdom: Congress should revise the bankruptcy laws because too many people use them to shirk bills they can pay.

"The free ride is over," declares Republican Sen. Chuck Grassley of Iowa, a lead sponsor of the effort, echoing the views that carried bankruptcy overhaul to a 306-to-118 victory in the House last week. Senate leaders have said they hope to hold a floor vote this summer.

But as the legislation moves quickly through Congress, many academics, lawyers and judges who specialize in bankruptcy law question why. A government-appointed commission spent two years studying the matter and was deeply divided. Five of its nine members found no major abuse of the system or need for a crackdown; only two endorsed anything like the bills Congress is embracing.

Delinquencies Rise

The percentage of consumers making late payments on credit-card bills rose slightly in the first quarter but remained well below the year-ago level, page A9.

More than 100 jurists wrote lawmakers to urge them to slow down, arguing: "The legislation presently before Congress would make fundamental changes . . . that have not been sufficiently considered."

Yet bankruptcy reform has a good chance of enactment this year. A major reason? A multimillion-dollar public-relations and lobbying blitz run largely by companies with the most to gain: credit-card issuers and other lenders.

In recent months, the six-year-old National Consumer Bankruptcy Coalition, which includes Visa U.S.A., MasterCard International Inc., the American Bankers Association and the National Retail Federation, has financed much of the research concluding that bankruptcy laws are too lax, and then it has spread the results in advertisements decrying "bankruptcies of convenience." It also has underwritten opinion polls designed to show public support for industry proposals.

Lenders make no bones about their "aggressive legislative and communications strategy" — as the American Financial Services Association's magazine, Credit, put it — to turn the obscure bankruptcy law into a hot political issue and to transform the image of lenders from scrooges to victims. "The usual creditor-vs.-debtor theme has been replaced," the article boasted. The industry's "goal of defining (actually 'redefining') the issue is working." The creditors even wrote their own suggested legislation; key provisions of that draft are in the House bill.

Contributions Increased

They also have stepped up their campaign contributions. In February, AFSA—the trade group for nonbank creditors ranging from American Express Co. to J.C. Penney Co.—held a $1,000-a-head fund-raising dinner for one of the reform effort's sponsors, Florida Republican Rep. Bill McCollum. Last year, AFSA gave about $100,000 to congressional candidates and political parties, up 30% from 1995, the previous nonelection year, according to the Center for Responsive Politics, a group that monitors political contributions.

Nobody disputes the fact behind the reform drive: The number of Americans seeking court protection from creditors soared to 1.4 million last year from 172,000 in 1978. The 1997 total is about one for every 70 households. In dispute are the causes of that trend and what should be done.

Creditor groups say that driving the bankruptcy boom are lax laws and a decline in the social stigma of bankruptcy. In addition, they say more and more people simply spend whether or not they have much chance of repaying the loans. They roll out lists of celebrities, such as actress Kim Basinger, who have filed for bankruptcy, and cite how-to books such as "Debt Free! Your Guide to Personal Bankruptcy Without Shame." Bankruptcy, they say, has become "a first stop, not a last resort" and "a financial-planning tool."

Studies Commissioned

To back up their arguments, creditors have funded studies by Ernst & Young LLP and Georgetown University's Credit Research Center that conclude that 5% to 10% of bankruptcy filers could pay all their debts if forced and that as many as 30% could pay a third. In all, the studies say, debtors shirk at least $4 billion a year in repayable debt. The cost, creditors say, is borne by everybody through higher interest rates and credit fees.

In another creditor-commissioned study, economic consultants at Wefa Inc. estimated that bankruptcies cost the U.S. economy $44 billion last year. Creditors call it a $400-a-family "hidden tax."

The creditors' proposed solution: Change the laws to, among other things, make it harder to get relief from credit-card debt through bankruptcy.

But not everyone sees that as the answer. "Some people in bankruptcy do have the ability to repay more," says Samuel Gerdano, head of the American Bankruptcy Institute, a trade group of

Please Turn to Page A9, Column 1

Continued From First Page

bankruptcy lawyers and judges in Alexandria, Va. "But there's no evidence that hasn't been paid for by a lobbying group showing that it's happening to an extent to justify this philosophical sea change."

Many analysts say the surge in bankruptcies reflects continuing hardship amid prosperity; divorce, layoffs and the loss of medical insurance can quickly put people in a bind. Sharing the blame is an industry-encouraged rise in consumer debt.

Moreover, officials at two arms of Congress, the General Accounting Office and the Congressional Budget Office, criticize the methodology of the industry-promoted studies. A CBO researcher said that assumptions used in one study "may contribute to an overstatement of repayment capacity" of bankrupt debtors. The GAO said the studies showing debtors could pay debts "should be treated with caution." Among various technical complaints, GAO and CBO officials say some of the studies don't use representative samples and contain optimistic assumptions about a bankrupt family's ability to keep its finances in order. The critics explain why the studies may overstate the amount of payable debt avoided, but don't provide an alternative estimate.

Tom Neubig, who directed the Ernst & Young study, counters that the accounting firm used "reasonable assumptions" and that there was "absolutely no bias" because of the creditor funding. Michael Staten, who did the Georgetown study, calls the GAO's criticisms invalid.

Extensive Hearings

All of this was supposed to be settled by the National Bankruptcy Review Commission, created by Congress in 1994. The commission held 21 hearings around the country, took testimony from more than 600 witnesses and weighed more than 2,300 written proposals from creditor and debtor representatives, judges and scholars. The majority rejected the notion of a worrisome rise in debtors out to scam lenders.

"Most families come to the bankruptcy courts as they have for years—seeking relief from debts they have virtually no hope of repaying," the commission concluded. "The sharp rise in consumer bankruptcy . . . may be more a function of a changing debt picture than of a sudden willingness to take advantage of the bankruptcy system."

The commission recommended nearly 200 changes to the system aimed at blocking both debtor abuse, such as people who file repeatedly, and creditor abuse, such as lenders skirting court rules to try to force strapped borrowers to repay.

But the group rejected the creditors' more far-reaching proposals. Only two commissioners endorsed the proposal most valued by credit-card companies and central to the House-passed bill: "means-testing," which would make it harder for higher-income people to file Chapter 7 bankruptcy and force them to file under Chapter 13 instead. Under Chapter 7, debtors can often wipe out unsecured debts, such as credit-card debt. Under Chapter 13, they have to work out a repayment plan.

Another creditor-backed proposal—which wasn't endorsed by a single commissioner but was included in both the House and Senate bills—makes it harder to escape certain credit-card obligations even if

THE WALL STREET JOURNAL
WEDNESDAY, JUNE 17, 1998

the debtor is in Chapter 7.

The credit-card industry's failure to win over the commission wasn't for lack of trying. A team of about two dozen lawyers and lobbyists representing lenders attended every session, whether in Washington; Akron, Ohio; or San Diego, and sought out individual commissioners. "I was inundated with literature through the mail," as well as phone calls and visits, says one, Caldwell Butler, a former Republican congressman from Virginia.

When it became clear by mid-1997 that, as Mr. Butler says, "the commission wasn't buying onto all that stuff," the creditors shifted gears and moved to undermine the panel. Phil Corwin, an American Bankers Association lobbyist, told a debtor's attorney, "We're going to nuke this when it gets to Capitol Hill." In mid-July, the creditors' coalition wrote Congress, arguing that the commission was "lacking in responsiveness to the testimony and other input" from the creditors and urging rejection of the panel's recommendations "as a starting point" for any bills.

The creditors accused the commission majority of pro-debtor bias. And the community of experts—judges, lawyers and scholars—who oppose the creditor proposals make up a "bankruptcy establishment" that "likes the status quo because it works well for them," says AFSA's chief lobbyist, Jeffrey Tassey. "Views dissenting from those of the bankruptcy community were effectively suppressed" by commission leaders, agrees Commissioner Edith Jones, a federal appellate judge who favored many creditor arguments.

So the financial industry, moving to work around the commission, amassed a war chest and an army of top-tier policy-shapers: for the media, Powell Tate Inc., led by former spokespeople for President Carter and Nancy Reagan; for public-opinion research, Clinton pollster Penn, Schoen & Berland and Frederick Schneiders Research. AFSA, Visa and MasterCard combined spent more than $2 million in lobbying last year, public records show. They hired top lobbyists with clout in both parties, including former Republican National Chairman Haley Barbour and former Clinton Treasury Secretary Lloyd Bentsen.

Mobilizing the Troops

In addition, the trade groups mobilized their foot soldiers across the country. "Want Bankruptcy Relief?" asked a headline in an AFSA mailing to members offering a toll-free "Grass Roots Hot Line" to patch local bankers through to their congressmen's offices. In at least five states with senators on the critical Judiciary Committee, coalitions were formed by bankers, other lenders and retailers. Though the groups claim to be local, their press releases are virtually identical.

The public-relations blitz focused on two themes: that bankruptcy filers are the 1990s version of President Reagan's "welfare queens" and that the average family picks up the tab. "It takes 33 Americans to pay for one bankruptcy of convenience." says one newspaper ad, featuring a tanned couple lounging in a white speed boat named "SCOT-FREE, BEVERLY HILLS."

The campaign has had great success with the press, which has often reported creditor-funded studies as fact, and with the public. In April, Frederick Schneiders conducted a poll telling people about the "recent study" asserting that $4 billion in payable debts had been wiped out last year and asking their reaction. The results: 76% of those asked were "critical" and 43% were "outraged," reported a creditor press release titled "Support High for Bankruptcy Law Reform."

The creditors also have moved swiftly to mute opposition. In March, the National Bankruptcy Conference—a group of top creditor and debtor attorneys, law professors and judges—issued a statement saying that "means testing is mean-spirited" and blaming creditors, not debtors, for the rise in bankruptcy filings. The next month, James N. Roethe, Bank of America's general counsel, sent letters to law firms around the country stating that "we note that some of the firms on Bank of America's approved counsel list, including yours, have partners who are members of the NBC." The letter explains the bank's "opposing position" and asks whether that law firm's conference member might care to publicly "disagree with the organization's public stance."

Intimidation Charged

Recipients of the letter "were intimidated," says the conference chairman, Kenneth Klee, a former Republican congressional staffer who now teaches law at the University of California at Los Angeles. "It was heavy-handed." A Bank of America spokesman says the letter was "absolutely not" intended to threaten law firms. "We often ask our friends to support us if they're of a like mind," he adds.

On Capitol Hill, where it counts, the industry's campaign has been successful. "I'm not influenced" by contributions, says Rep. McCollum, the beneficiary of the AFSA fund-raiser. "I happen to believe that" bankruptcy reform "is the right position for consumers." He introduced legislation containing many of the restrictions that creditors wanted last September—a month before the commission was scheduled to issue its recommendations. Within two months, the legislation had picked up 150 co-sponsors across the political spectrum and became the basis for the bill that passed the House. Though the commission concluded that creditors are as likely to abuse the bankruptcy system as debtors, the current House bill contains no significant limits on creditors. Its "Debtor Bill of Rights" emphasizes "protection" from bankruptcy lawyers.

The Clinton administration says it supports the idea of new limits on debtors but has some objections to the pending bills, especially the stricter House version. Creditors note that that bill, which they prefer to the Senate's, passed with a "veto proof" majority of more than two-thirds.

"What's really lost" in the pending legislation "is the responsibility of the credit-card industry" for fueling the surge in bankruptcies, Sen. Dick Durbin says. The Illinois Democrat was a co-sponsor of the original Senate bill with Sen. Grassley because, he says, he thought they had crafted a balance between debtors and creditors. But with the bill now shifted more toward creditors, Mr. Durbin says he isn't sure whether to support it when the Senate votes on it. "This bill has been written by a lot of people who have very special interests to protect," he says.

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THE WALL STREET JOURNAL
WEDNESDAY, JUNE 17, 1998

Bankruptcy

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 for 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*

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.

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

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.

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.

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.

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. 707(b) Terminology -- "Abuse" or "Inappropriate Use"

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 BANKRUPTCY 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.

Nondischargeability provisions. 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."

<u>Child Support and Alimony Collection Measures.</u> 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.