

Changing Perceptions of Consumers Shape Bankruptcy Laws

By Alan D. Eisler

On April 20, 2005, President Bush signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), legislation that, among other things, attempted to restrict consumers' ability to discharge their debts in Chapter 7 bankruptcy cases where there is rarely any repayment made to creditors. BAPCPA's enactment followed years of lobbying by the consumer credit industry which had argued that consumers were too easily eliminating credit card debts in Chapter 7 cases. At the time it enacted BAPCPA, Congress considered consumers to be culpable for their debts and viewed the consumer credit industry as a victim of a bankruptcy system that made eliminating credit card debt all too easy. Times have changed. Less than four years later, Congress regards consumers as victims of unscrupulous mortgage

lenders and Wall Street financiers whose securitized mortgage loans have undermined the country's financial well-being. Congress is now considering once unthinkable legislation to modify lenders' rather than consumers' rights.

In order to crack down on perceived abuse by consumers, BAPCPA imposed a "Means Test" to determine eligibility to file Chapter 7 bankruptcy. The Means Test first looks at the nature of an individual's debts. If those debts are primarily business rather than consumer debts, the Means Test does not apply and the person's Chapter 7 case cannot be dismissed for presumed "abuse." If a person's debts are predominantly consumer-oriented (e.g., related primarily to household or personal use), the Means Test applies and determines whether a person is presumed to be able to repay a portion of his or her debts. The Means Test does

so by first calculating whether an individual's annualized household income exceeds national averages (determined by the Internal Revenue Service) based upon household size. If the income is below the national median average, he or she is deemed to have passed the Means Test and is presumed to be eligible for a Chapter 7 bankruptcy filing. If a person's annualized income exceeds the national median average based upon family size, then the Means Test looks at his or her monthly income and expenses, some of which (e.g., food, clothing, utilities and household supplies) are capped.

By artificially limiting monthly expenses, the Means Test can make it appear as if a consumer has excess monthly income with which to repay a portion of his or her debts. If, under the Means Test's artificially capped expenses, a person can repay either 25 percent or \$10,000 of his

or her unsecured debt (e.g., debts for which there is no collateral to ensure repayment) over a five-year period, the person's bankruptcy filing is presumed to be "an abuse of the provisions of" the Bankruptcy Code and subject to dismissal. Although an individual has the right to rebut the presumption of abuse, as a practical matter, it is costly to do so and fraught with risk. To avoid an outright dismissal of his or her case, an individual may opt to convert to Chapter 13 and attempt a repayment plan.

Fortunately for Maryland debtors, the Means Test allows individuals to take a deduction for their actual (rather than artificial) monthly mortgage payments. Due to soaring home prices and readily available credit during the first half of the decade (2000-05), many consumers have very high monthly mortgage payments, which enable them to "pass" the Means Test, even though other household expenses may have been artificially lowered.

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Ironically, the housing bubble and the easy credit that went along with it created the large mortgages that enable many debtors to pass the Means Test and remain eligible to file for Chapter 7 bankruptcies.

With housing prices falling and credit much harder to come by, Congress now views consumers as victims – and lenders as culprits. Among other things, Congress is considering potential moratoriums on foreclosures and allowing bankruptcy judges to modify the terms of home mortgages – a practice perennially protested by the mortgage lending industry – to enable consumers to retain their homes. Prior to BAPCPA's enactment, consumers were viewed as spend-thrifts whose recourse to Chapter 7 bankruptcy was far too expansive and needed to be curtailed. Fast-

forward less than four years and the same borrowers are now seen as victims' of the same formerly aggrieved lenders whose loans were being too easily discharged.

These proposed changes to bankruptcy laws seem to be shaped by Congress's perception of consumers rather than a dispassionate assessment of what bankruptcy laws should accomplish. If Congress believes that individuals deserve a fresh start and should be able to retain their homes after eliminating other debts via bankruptcy, then it should focus more on how best to accomplish these ends and less on who is responsible for the country's financial woes.

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