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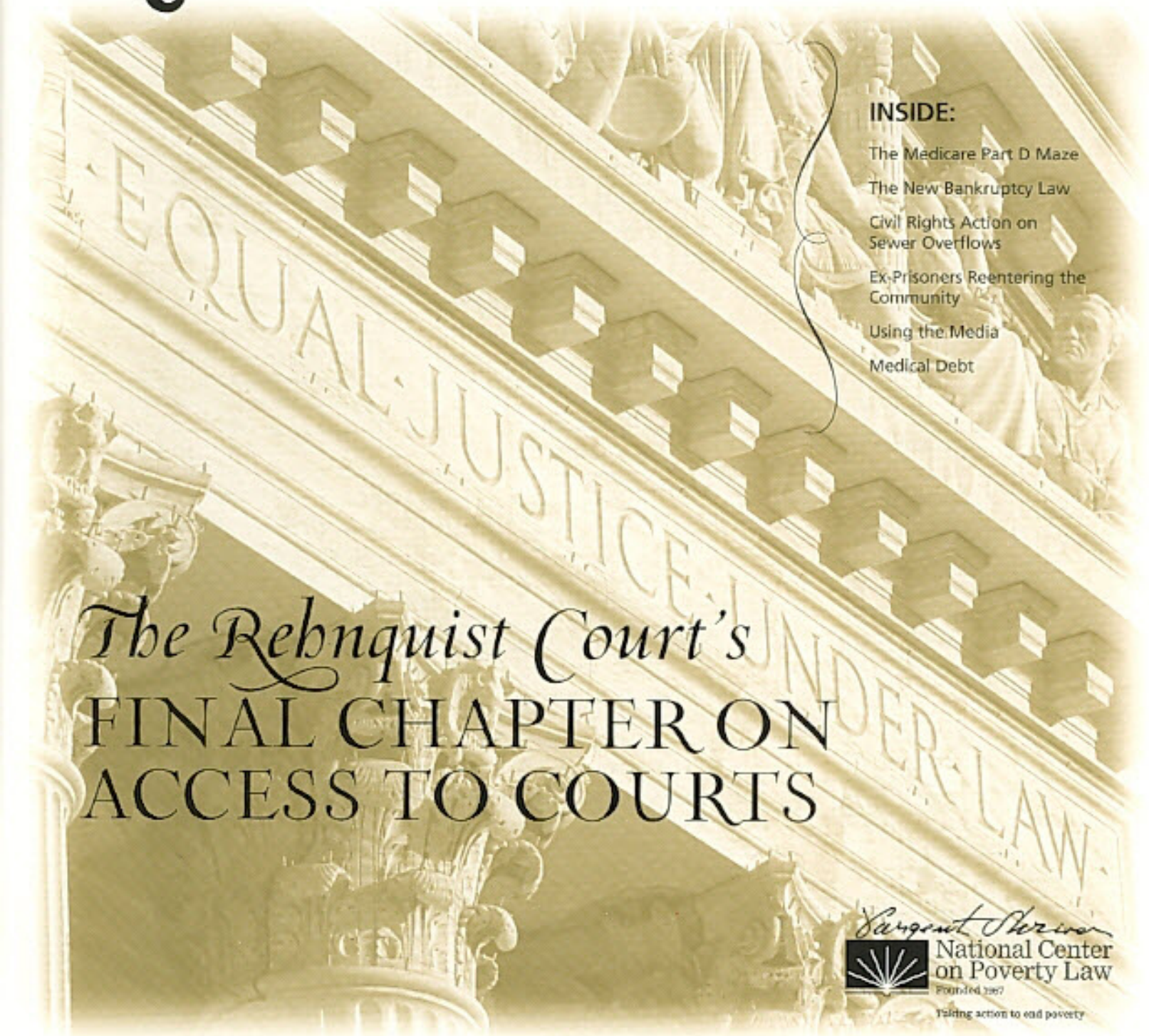


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# *The Rehnquist Court's* FINAL CHAPTER ON ACCESS TO COURTS

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# The New Bankruptcy Law: Challenge and Opportunity

By David S. Yen and Jeana Kim Reinbold

When the Bankruptcy Code was enacted 26 years ago, CLEARINGHOUSE REVIEW published an article calling for legal aid attorneys to seize the occasion and expand the use of bankruptcy for low-income clients.[1] Since then legal aid lawyers have represented clients in thousands of bankruptcy cases, some groundbreaking, and some routine, usually as debtors, but sometimes as creditors.[2] The bankruptcy legislation which took full effect on October 17, 2005, presents a similar challenge to legal aid and pro bono lawyers: to preserve as much as possible the availability and effectiveness of bankruptcy relief for low- and moderate-income debtors and, secondarily, to ensure that the rights of low-income creditors are protected to the extent possible when the adverse party files for bankruptcy.[3]

One purpose of filing for bankruptcy is a fresh start for the honest but unfortunate debtor.[4] Studies assert that 87 percent of debtors cited job loss, medical problems, divorce or separation, or some combination of these three as the reason that they filed for bankruptcy.[5] For the working and middle class, bankruptcy has become an important safety net. As low-income clients moved from the welfare rolls into the ranks of the working poor, bankruptcy also became an increasingly important resource for them. For some problems, such as preservation of subsidized housing or utility service, bankruptcy is uniquely effective for poor people.

Proponents of the new bankruptcy law said that the law would prevent abuse of the bankruptcy system through a means test that would screen out the prosperous debtor who could afford to pay his debts, while leaving bankruptcy available as before for the deserving debtor. If only that were so: the less publicized changes in the Bankruptcy Code decrease access to the bankruptcy system even for the "deserving debtor" and reduce the effectiveness of bankruptcy for many of those who are allowed to file.

A means test is a characteristic of a welfare program, not a general entitlement program. Whether consumer bankruptcy will become more and more like a welfare program instead of a law of general application is an open question.[6] One similarity that is already apparent is that several provisions of the new law will reduce consumer bankruptcy filings in ways that are similar to welfare rules and practices that led to reduced welfare caseloads.

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[1] Henry J. Sommer, *New Law of Bankruptcy: A Fresh Start for Legal Services Lawyers*, 13 CLEARINGHOUSE REVIEW 1 (May 1979)

[2] See, e.g., *Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S. 552 (1990); *Kelly v. Robinson*, 479 U.S. 36 (1986); *In re Stoltz*, 315 F.3d 80 (2d Cir. 2002) (Clearinghouse No. 52,764); *Ross v. Metropolitan Dade County*, 142 B.R. 1013, 1015 (S.D. Fla. 1992), *aff'd without op.*, 987 F.2d 774 (11th Cir. 1993) (representing debtors); *Cohen v. de la Cruz*, 523 U.S. 213 (1998) (representing tenants who were creditors of a landlord who filed for bankruptcy)

[3] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23. The Act has not yet been codified (as of this writing). Several publications have compiled the changes. Two that we have found useful are WILLIAM HOUSTON BROWN & LAWRENCE K. AHERN III, 2005 BANKRUPTCY REFORM LEGISLATION WITH ANALYSIS (2005), and ALAN N. RESNICK & HENRY J. SOMMER, COLLIER PORTABLE PAMPHLET: TEXT OF THE BANKRUPTCY CODE AND ADDITIONAL STATUTORY PROVISIONS (Supp. 2005).

[4] *Local Loan v. Hunt*, 292 U.S. 234, 244 (1934).

[5] ELIZABETH WARREN & AMELIA WARREN TYAGI, THE TWO-INCOME TRAP 81 (2003).

[6] Only cases filed by debtors with primarily nonconsumer debts are not subject to dismissal for abuse. 11 U.S.C. § 707(b) (2000).

Attorneys for low-income debtors have several challenges and a major opportunity. The challenges are to understand the changes so that they can advise their clients; to help their clients overcome barriers to entry when bankruptcy is appropriate; and to represent them in a much more complicated and uncertain bankruptcy system. The opportunity is that legal aid and pro bono lawyers can play a major role in shaping bankruptcy practice under the new law because they will be more able to litigate significant cutting-edge issues than many private attorneys: simply to file a case costs more, and clients of private attorneys may be unable to afford such litigation on top of the attorneys' increased base fees.

We discuss here some of the important changes in the new bankruptcy law, but we cannot cover them all. For example, the new code alters allowed exemptions, reaffirmation disclosures, rights of ex-spouses and child support agencies, the rules on conversion of cases, and treatment of retirement accounts, none of which we discuss here. To represent clients adequately and avoid pitfalls in the new law, attorneys must familiarize themselves with the new code provisions.

## I. Barriers to Chapter 7 and Chapter 13 Bankruptcy Relief

A new credit-counseling provision and requirements that debtors submit extensive financial documentation both initially and throughout the case increase the barriers to bankruptcy relief. In some cases these may make it nearly impossible for persons in an emergency situation to get timely relief under Chapter 7 or Chapter 13.

### A. The Requirement to Receive Credit Counseling

To be even eligible to file a case, an individual must now have "received from an approved nonprofit budget and credit-counseling agency described in Section 111(a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis."[7] New Section 111 outlines the extensive new duties of the U.S. Trustee in administering and regulating these "nonprofit budget and credit counseling" programs.[8]

Exceptions to the credit-counseling requirement are limited to debtors who have tried and been unable to get appropriate counseling for at least five days before the case is filed; debtors who are so disabled that they cannot get credit counseling, even by phone or on the Internet; debtors who are on active military duty in a combat zone; or debtors who describe other exigent circumstances satisfactory to the court. Debtors unable to get credit counseling under these very limited circumstances may still file, but they must then get credit counseling within thirty days.[9]

This requirement increases the cost of bankruptcy and increases the time between the realization that bankruptcy may be necessary and successfully filing a case. Inappropriate credit counseling will deflect some debtors from filing for bankruptcy.[10] The higher cost will be inconsequential for some prospective debtors, but for others it could be calamitous. People often file for bankruptcy under emergency situations—such

[7] Pub. L. No. 109-8, § 106(a), 119 Stat. 23, 37 (2005) (to be codified at 11 U.S.C. § 109(h)(1)).

[8] *Id.* § 106(e)(1), 119 Stat. at 39–41( to be codified at 11 U.S.C. § 111).

[9] *Id.* § 106(a), 119 Stat. at 37 (to be codified at 11 U.S.C. § 109(h)(2)). Note that this could keep a debtor from filing before a foreclosure, repossession, tax sale, eviction, or other dire event that is less than five days away if the debtor did not realize early that bankruptcy was an appropriate solution to the financial emergency causing the deadline *and* that she had to go through credit counseling as well as prepare the bankruptcy documents.

[10] One rationale offered for the credit-counseling and debt-relief agency provisions of the new bankruptcy act is that people with better alternatives are filing for bankruptcy due to the wiles of bankruptcy attorneys. Whether this was a major problem or not, the credit-counseling requirement likely will result in some debtors failing to file for bankruptcy when it is their best option. Advocates for low-income debtors can help protect their clients' interests by monitoring the performance of credit-counseling agencies and reporting problems to state and federal agencies with jurisdiction over credit-counseling agencies and to the U. S. trustee or bankruptcy administrator who certified the credit-counseling agency.

## Bankruptcy Listserv

Do you represent low-income clients in bankruptcy cases? Keep up with new developments in bankruptcy by joining the legal services bankruptcy listserv. Moderated by David Yen and John Rao, the listserv is open to attorneys in legal aid programs, pro bono coordinators, and professors supervising law school clinics. To join, send your name, address, affiliation, and e-mail address to John Rao at the National Consumer Law Center, jrao@nclc.org.

as to prevent the foreclosure of a home, car repossession, eviction for nonpayment of rent, shutoff of necessary utilities, a tax sale, seizure of wages, bank accounts, or other assets—or under some other emergency deadline. Who wins the "race to the courthouse" may be the most important fact in whether the debtor will receive effective bankruptcy relief.[11] For example, in Illinois a homeowner who filed her bankruptcy petition after the foreclosure sale of her home, but before that sale was confirmed by the state court, filed too late to use Chapter 13 bankruptcy to save her home.[12] In a minority of states, if the creditor repossesses a motor vehicle before the debtor files for bankruptcy, the creditor does not have to return the vehicle to the debtor.[13] The credit-counseling requirement places the debtor, who may not even realize that he is in a race, several paces behind the creditor. The problem of delay is most acute in Chapter 13 cases that need to be filed before a deadline.

Attorneys for debtors can lower this barrier in several ways. Attorneys should identify which credit-counseling agencies are reputable and can give the required counseling on short notice. One agency may not be best for all clients. Some agencies may offer services only to a certain group, such as the elderly. If the client has limited English proficiency, there may be only one approved counseling agency that offers counseling in the client's primary language.[14] While all credit-counseling agencies must offer the required briefing "without regard to ability to pay," they are unlikely to volunteer this information to debtors. Attorneys should know the fees charged and whether the agency has effective procedures for providing services without a fee. Attorneys should consider making a computer with Internet access available for clients to complete Internet credit-counseling sessions in the attorney's office, while the attorney prepares the bankruptcy petition. This may require establishing an ongoing relationship with an Internet credit-counseling agency.[15] Programs should design their outreach efforts and intake procedures to encourage clients who are strong candidates for bankruptcy to contact the legal aid or pro bono program first so that the attorney can make sure that they receive credit counseling that is actually necessary and appropriate. In many cases the client decides not to file for bankruptcy after consulting the attor-

[11]Some bankruptcy rules are designed to reduce the importance of winning this race. See, e.g., *Union Bank v. Wolas,* 502 U.S. 151, 160-61 (1991).

[12]*Colon v. Option One Mortgage Corporation*, 319 F.3d 912 (7th Cir. 2003).

[13]See, e.g., *Bell-Tel Federal Credit Union v. Kalter (In re Kalter),* 292 F.3d 1350 (11th Cir. 2002) (interpreting Florida law).

[14]If debtors with limited English proficiency encounter problems, programs funded by the Legal Services Corporation (LSC) may have a duty to make up for the deficiencies of the credit-counseling agencies. See LSC Program Letter 04-2, Services to Client Eligible Individuals with Limited English Proficiency (Dec. 6, 2004); Executive Order 13166, 65 Fed. Reg. 50119 (Aug. 11, 2000). Executive Order 13166 applies both to recipients of federal financial assistance (§ 3) and to federally conducted programs and activities (§ 2). The Office of the U.S. Trustee is part of the U.S. Department of Justice, which is the lead agency for implementation of the limited-English-proficiency requirements of Title VI of the Civil Rights Act of 1964. Both LSC and non-LSC-funded attorneys serving low-income debtors should monitor whether the policies of the Office of the U. S. Trustee toward limited-English-proficient clients are consistent with the letter and spirit of Title VI and Executive Order 13166.

[15]Internet credit-counseling agencies will probably require payment by credit or debit card, while the potential debtor may have neither. If the attorney has a standing account with the credit-counseling agency, the client can pay the attorney in cash.

ney, thus avoiding the need to pay for credit counseling.[16]

### B. Increased Paperwork

Filing for bankruptcy was once similar to filing a tax return. A debtor would file a bankruptcy petition and accompanying forms under penalty of perjury and, if everything was in order, could obtain a discharge without any additional documentation. The possibility of a trustee or creditor objecting, and in the worst-case criminal prosecution, was considered sufficient incentive for the debtor to tell the truth.

This has changed. After a debtor files, several new documentation requirements apply to both Chapter 7 and Chapter 13 bankruptcies. The bankruptcy system is moving from the income-tax model, which relies on self-reporting to a significant degree, to the welfare model, which requires documentation of eligibility. Due to the increased administrative burdens put upon an applicant, the latter approach is far more likely to lead to denial of a benefit to which the applicant is substantively entitled.[17]

Taken individually, each additional requirement may be justified. For example, in recent years trustees required debtors to have photo identification and proof of their social security number at the creditors' meeting. The new law provides a statutory basis for this practice.[18] However, the new law also requires production of other documents that may not be so easily obtained, and the cumulative effect of all these requirements imposes significant additional costs on low-income debtors.[19]

To start the bankruptcy process, a person must file certain documents with the bankruptcy court. These documents formerly included the petition, the schedules listing creditors, assets, current income and expenditures, and the statement of financial affairs. For Chapter 13, another required document is the plan. In addition to the foregoing items, unless otherwise ordered by the court, the person must now file:

- the debtor or attorney's certified statement that the debtor received the notice required under the amended Section 342(b) of the Code;
- copies of all payment advices (pay stubs) or other evidence of payment received within the sixty days before the petition filing date; [20]
- a statement of the amount of monthly net income, showing how the amount is calculated; and

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[16]Clients are often unaware of their rights under state or federal consumer protection laws, such as the federal Truth in Lending Act, state unfair and deceptive practices acts, and federal and state laws regulating debt collection activity. They may have straightforward defenses based on basic contract law principles. In the past filing for bankruptcy was often cheaper or more convenient than defending against collection attempts even when the debtor had valid defenses. Filing for bankruptcy in such situations may be less appropriate after the new bankruptcy act. Attorneys who are counseling clients seeking bankruptcy should be alert to these alternative ways of solving their clients' financial problems. They should also be able to recognize when their clients may not be receiving benefits to which they are entitled and where to refer the client for help in obtaining those benefits if the attorney does not have expertise in that area. Many clients are judgment-proof because their income may not be garnished and their assets are fully exempt under state laws, but they do not know this. Others may think that they may be put in jail for nonpayment of ordinary debt. Once a client is advised by an attorney that his liberty, income, and property are safe from collection efforts, the client may decide that filing for bankruptcy is not necessary.

[17]A recent study found a statistically significant correlation between administrative practices that blocked access to benefits and declining welfare caseloads in Cook County, Illinois. Evelyn Z. Brodkin et al., Accessing the Safety Net: Administrative Barriers to Public Benefits in Metropolitan Chicago 49–50 (2005), available at www.povertylaw.org/advocacy/hotline_research/full_hotlines_report_2.pdf.

[18]Pub. L. No. 109-8, § 315(b), 119 Stat. 23, 91 (to be codified at 11 U.S.C. § 521(h)).

[19]The proposed interim bankruptcy rules also require debtors to give the trustee copies of bank statements. Fed. R. Bankr. P. 4002(b)(2)(B).

[20]Some courts have already issued orders varying the new requirements. E.g., the U.S. Bankruptcy Court for the Northern District of Illinois has already issued a standing order that payment advices shall not be filed with the court unless ordered. Instead debtors must submit them to the case trustee at least seven days before the creditors' meeting. Standing Order Revised September 28, 2005, effective October 17, 2005, available at www.ilnb.uscourts.gov/GeneralOrders/Filing_of_Payment_Advices_Pursuant.pdf.

- a statement disclosing any reasonably anticipated increases in income or expenditures over the twelve-month period following the petition filing.[21]

Subject to a debtor's timely filed request for an extension or to continuation of the case by the trustee, new Section 521(i) provides that the case is automatically dismissed if any of these items is not filed within forty-five days from the date of the filing of the petition.[22]

Every Chapter 7 debtor must complete a new Form 22, "Statement of Current Monthly Income and Means Test Calculation."[23] Because the threshold for the means test is the state median income, very few low-income debtors will fail the means test.[24] Most will have to complete only fifteen of the fifty-six questions on the form.

Setting forth the debtor's current monthly income requires more work than preparing the Schedule of Current Income of Individual Debtor (Schedule I), the only such document required under the old Bankruptcy Code. For each category of income, the debtor must calculate the total income received in the six months prior to the month in which the case was filed, then divide by six. If the debtor's income fluctuated at all, the debtor must review more records than before. The statutory definition of "current monthly income" is pernicious because inclusion of past income may yield a higher income than what is actually available to the debtor to pay his debts in the future. Debtors commonly file for bankruptcy because of a drop in income due to job loss or a failing business. Inclusion of income which the debtor will never have again in determining whether a debtor passes the means test may force even the well-advised debtor to make a choice between filing sooner (and failing the means test), to get relief from wage garnishment or other collection efforts, and delaying filing until the phantom income no longer puts the debtor over the median income. Failing the means test could cause dismissal of the debtor's Chapter 7 bankruptcy, and any Chapter 13 filing would have to propose a plan that pays creditors for sixty months, or arguably the equivalent value of payments to be received in sixty months, instead of thirty-six months under the old law.

At least seven days before the date set for the meeting of creditors required under Section 341(a), the debtor must tender to the trustee and to any creditor who requests it a copy of any required federal income tax return or transcript for the most recent tax year ending before the start of the case.[25] The court shall dismiss the case if this is not done.[26] A party in interest or the court may request copies of tax returns or amendments that

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[21]Pub. L. No. 109-8, § 315(b), 119 Stat. 23, 89–90 (to be codified at 11 U.S.C. § 521(a)(1)(B)(iii)–(vi)).

[22]*Id.* § 316, 119 Stat. at 92 (to be codified at 11 U.S.C. § 521(i)).

[23]The Statement of Current Monthly Income and Means Test Calculation is Form 22A, 22B, or 22C, depending on the Bankruptcy Code chapter under which the case is filed. The interim new and revised forms for the implementation of the new law are available at www.uscourts.gov/rules/new_and_revised_official_forms.html. Note that the term "current monthly income" is a term of art and does not correspond to the common understanding of that term. See Pub. L. No. 109-8, § 101(b), 119 Stat. 23, 32 (to be codified at 11 U.S.C. § 101(10A)).

[24]E.g., Mississippi, with a median income of at least 230 percent of the poverty guidelines at all household sizes, has the lowest median income of all states, according to the 2004 census. As discussed in the next paragraph, a low-income debtor whose actual income is well below the state median income may still fail the means test based on phantom income. Failing the means test gives rise to a presumption that a Chapter 7 bankruptcy is an abuse of the system and justifies dismissal of the case if the debtor cannot rebut the presumption by demonstrating the debtor's "special circumstances" or convert the case to Chapter 13 or Chapter 11. Demonstrating special circumstances would include justifying additional expenses to deduct from the determined income; justifying these expenses may involve additional litigation.

[25]*Id.* § 315(b), 119 Stat. at 90 (to be codified at 11 U.S.C. § 521(e)(2)). For clients who cannot find their tax returns, attorneys should learn how to obtain tax transcripts. Obtaining a tax transcript from the Internal Revenue Service (IRS) is often quicker and cheaper than getting a copy of the physical return. Usually the quickest way to get a simple tax transcript from the IRS is to call the national priority hotline at 866.860.4259. Be prepared to request the simple transcript (MFTRA-X) for each year your client is believed to owe taxes and to fax to the IRS a power of attorney Form (2848) or Form 8821 with a cover letter stating the type of transcript, tax years, type of tax, and your client's social security number and address.

[26]*Id.* § 315(b), 119 Stat. at 90 (to be codified at 11 U.S.C. § 521(e)(2)(B)).

come due or are completed while a case is pending.[27] A taxing authority may request an order converting or dismissing the case if tax returns that come due are not filed.[28]

The following additional items must also be filed with the court: a certificate from the nonprofit budget and credit-counseling agency that counseled the debtor before the case filing, and a copy of any debt repayment plan developed through the agency.[29]

### C. Restrictions on Private Attorneys

The new bankruptcy law contains three sections that regulate private bankruptcy attorneys who represent consumer debtors, attorneys who henceforth must market themselves as "debt-relief agencies."[30] Whether the new rules were necessary to protect debtors from unscrupulous attorneys is now beside the point. The consensus among private attorneys is that these requirements, as well as the other new requirements, will lead to increased attorney fees. In the past the low-income debtor often could save enough money to pay a private attorney, and many legal aid offices justified severe limitations on the kinds of bankruptcy cases they took because bankruptcy was affordable for some of their clients. This may no longer be so.

At least two of the new rules that apply to private attorneys in our opinion go beyond any legitimate purpose of consumer protection. These rules could impede a potential debtor from making a truly informed decision on his best course of action. One rule prohibits private attorneys from advising potential debtors to incur more debt in contemplation of bankruptcy.[31] However, in many circumstances incurring debt knowing that one will be filing bankruptcy soon is completely proper. For example, to "trade down," that is, replace a car with high loan payments and operating expenses with a more modest car, with lower payments and higher gas mileage, is legal for a debtor. A debtor who has lost all her furniture in a flood may buy furniture on credit if she intends to reaffirm the debt after filing bankruptcy. This restriction on giving accurate legal advice is similar to a provision that tried to prevent attorneys from advising clients on how to qualify for Medicaid by transferring assets in contemplation of entering a nursing home. That restriction was permanently enjoined on First Amendment grounds in *New York State Bar Association v. Reno*.[32] Whether this new code provision is similarly vulnerable remains to be seen.

Sometimes a client's best course may be to obtain a loan even though she will be filing for bankruptcy almost immediately. Suppose the client received a notice of lease termination for nonpayment of rent and the notice has only one or two days to run. If the client is unable to pay or to obtain credit counseling before the expiration of the time to pay, but is able to obtain a loan for the necessary amount from a friend, relative, or even a payday loan company (!), taking the loan to cure the rent default may be the best course of action. As discussed, to incur credit in contemplation of bankruptcy is not illegal if the debtor intends to repay the money. An attorney not subject to 11 U.S.C. § 526(a)(4)—i.e., a legal aid or pro bono attorney—can advise the client of these options, file the necessary documents to follow through, and if necessary defend the client from any baseless charges of fraud.

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[27] *Id.* 119 Stat. at 90–91 (to be codified at 11 U.S.C. § 521(f)).

[28] *Id.* § 720, 119 Stat. at 133–34 (to be codified at 11 U.S.C. § 521(j)).

[29] *Id.* § 106(d), 119 Stat. at 38 (to be codified at 11 U.S.C. § 521(b)(c)). The record of any interest that the debtor has in an education individual retirement account or qualified state tuition program must also be reported but should be included in the appropriate place on Schedule B.

[30] *Id.* §§ 227–229, 119 Stat. at 67–72 (to be codified at 11 U.S.C. §§ 526–528).

[31] *Id.* § 227(a), 119 Stat. at 68 (to be codified at 11 U.S.C. § 526(a)(4)).

[32] *New York State Bar Association v. Reno*, 999 F. Supp. 710 (N.D.N.Y. 1998).

A second rule requires that private attorneys give "assisted persons" (the new term for most consumer clients contemplating bankruptcy) disclosures which are incomplete and in overall effect misleading.[33] The disclosures misleadingly state that the prospective debtor "will have to pay a filing fee"; in fact, as discussed below, the filing fee may be waived in a Chapter 7 case. The disclosures also emphasize the debtor's right to represent herself in the bankruptcy proceeding and in any litigation arising out of the bankruptcy. This is true, but that Congress chose this moment to emphasize the right to proceed pro se is ironic, given the increased complexity of filing bankruptcy.

No restrictions have been placed on Legal Services Corporation–funded programs in their representation of people affected by bankruptcy reform.[34] Lawyers who work for nonprofit organizations with 501(c)(3) status and attorneys who represent only consumer debtors pro bono are not subject to these new requirements.[35] For once, clients of legal aid programs and pro bono lawyers, by law, should expect to receive better advice from their attorneys than clients who pay private attorneys.

### D. Debtor Education as a Condition of Discharge

Before the debtor may get a discharge, she must complete an approved financial education course.[36] Even if the debtor obtains this at no cost, she may incur other costs such as time lost from work and transportation costs. The attorney can assist the debtor in finding the best financial education course for her; while financial education is available at many credit-counseling agencies, the debtor is not required to use the same organization for financial education as she used for credit counseling. Here again the course must be completed without regard to ability to pay.

## II. Chapter 7 Changes

Chapter 7 bankruptcy remains a viable remedy for many debtors with debt problems, but the new law has cut back on Chapter 7's effectiveness in many areas. Some changes affect debtors across the board while others affect only some debtors.

One change is the increase in the time before a discharge can be entered in a Chapter 7 case which follows another Chapter 7 or Chapter 11 case from six to eight years.[37] Other potentially significant changes are limitations on the availability of the "automatic stay" in cases where the debtor files a case within one year after a previous case is dismissed; where the debtor files after a judgment for possession of a rental unit; or where an *in rem* order was entered against real estate in a previous bankruptcy case.[38] Clients must be advised of these changes,

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[33]Pub. L. No. 109-8, § 226(a), 119 Stat. 23, 66 (to be codified at 11 U.S.C. §§ 101(3)) (defining "assisted persons"); *id.* § 228(a), 119 Stat. at 69–70 (to be codified at 11 U.S.C. §§ 527–528) (disclosures).

[34]The restrictions in the 1996 appropriations act for the LSC included bans on certain legislative advocacy, class actions, and challenges to welfare reform. Pub. L. No.104-134, §§ 504(a)(2)–(4), (7), (16), 110 Stat. 1321, 1321–53, 1321–56 (1996).

[35]The definition of "debt-relief agency" applies only to persons who are paid for providing bankruptcy assistance; attorneys working pro bono are not debt-relief agents. Pub. L. No. 109-8, § 226(a), 119 Stat. 23, 67 (to be codified at 11 U.S.C. § 101(12A)(B)). The definition also excludes nonprofit organizations with 501(c)(3) status under the Internal Revenue Code; a public interest law firm may, without being considered a debt-relief agency, charge clients a modest fee to cover overhead. *Id.*

[36]*Id.* § 106(b), 119 Stat. at 38 (to be codified at 11 U.S.C. § 727(a)(11)) (Chapter 7); *id.* § 106(c), 19 Stat. at 38 (to be codified at 11 U.S.C. § 1328(g)(1)).

[37]*Id.* § 312, 119 Stat. at 87 (to be codified at 11 U.S.C. § 727(a)(8)). The time before another discharge may be entered in a Chapter 7 case which follows a Chapter 12 or Chapter 13 where the debtor received a discharge remains six years, unless more than 70 percent of the claims in the case were paid; in that case, there is no waiting period to receive a Chapter 7 discharge. 11 U.S.C. § 727(a)(9) (2000).

[38]Pub. L. No. 109-8, § 302, 119 Stat. 23, 75–77 (to be codified at 11 U.S.C. §§ 362(3), (4)) (case filed after recent dismissal); *id.* § 311(a), 119 Stat. 84 (to be codified at 11 U.S.C. § 362(b)(22)) (judgment of possession already entered ); *id.* § 303, 119 Stat. at 77–78 (to be codified at 11 U.S.C. § 362(d)(4), (b)(20)) (*in rem* relief against real property).

and the attorney should explain how this may affect the client should problems arise next time. The attorney must also be prepared to take immediate action, ideally with the filing of the case, for cases which may require a motion to extend or impose the "automatic stay."

The definition of "household goods" for purposes of lien avoidance has been narrowed, giving certain creditors leverage to threaten repossession to motivate debtors to reaffirm debts.[39] Redemption must be at replacement value, overruling the many cases holding that only wholesale value was required.[40] This increases the cost of redemption and may restrict the developed market of lenders willing to lend to debtors, at admittedly high rates, so that debtors could redeem for less than the full amount owed on the debt. The new law, at least in theory, eliminates the option of "retain and pay" without reaffirming for debtors who were current when they filed for bankruptcy and who continue to make their payments.[41]

One positive change for low-income debtors is that, for the first time, the filing fee for a Chapter 7 case may be waived.[42] However, the process is not simple: the new form requires a debtor seeking a fee waiver either to attach Schedules A, B, I, and J or to calculate the income that will appear on Schedule I, estimate the income that will appear on Schedule J, and answer four questions, with subparts, about his assets.[43] Seven additional questions are about payments to attorneys or petition preparers, prior bankruptcies, and any other circumstances bearing on the ability to pay the filing fee.

## III. Chapter 13 Changes

For a low-income person, the effort involved to complete a Chapter 13 case is considerable. Assisting clients in defining clearly what their long-term goals are as early in the process as possible is more important than ever.

### A. Additional Document Production and Filing Requirements

A person filing a Chapter 13 case, in addition to all the documents that need to be filed for a Chapter 7 case, must file a Chapter 13 plan and Statement of Current Monthly Income and Means Test Calculation (Form 22C). Pursuant to new Section 1308, the Chapter 13 debtor must file with all appropriate taxing authorities any returns that were required for taxable periods over the four-year period ending on the date the petition is filed by the day before the first date of the Section 341(a) meeting of creditors.[44] The trustee may delay the meeting for a reasonable period up to 120 days to allow the debtor to file the returns.[45] On request of a party in interest or the U.S. trustee, the court shall dismiss or convert a case to Chapter 7 if any of the returns are not filed.[46] All the required returns must be

[39] *Id.* § 313(a), 119 Stat. at 87 (to be codified at 11 U.S.C. § 522(f)(4)(A)).

[40] This change does not appear in the section allowing redemption (11 U.S.C. § 722 (2000)) but is in the section on determination of secured status. Pub. L. No. 109-8, § 327, 119 Stat. at 99–100 (to be codified at 11 U.S.C. § 506(a)(2)).

[41] If the debtor does not reaffirm, redeem, or avoid the lien within forty-five days of the creditors' meeting, the stay is terminated, unless the trustee moves for an extension of the stay. *Id.* § 304(1), 119 Stat. at 78–79 (to be codified at 11 U.S.C § 521(a)(6)). The effect of this section is unclear in jurisdictions with laws restricting the creditor's ability to repossess when the debtor is current in his payments, despite other defaults.

[42] Pub. L. No. 109-8, § 418, 119 Stat. 23, 108–9 amends 28 U.S.C. § 1930 to allow waiver of the filing fee for debtors whose income is below 150 percent of the poverty level, and thus legislatively overrules *United States v. Kras*, 409 U.S. 434 (1973). This does not apply to any other chapters.

[43] The new form is Official Form 3B, "Application for Waiver of the Chapter 7 Filing Fee for Individuals Who Cannot Pay the Filing Fee in Full or in Installments," available at www.uscourts.gov/rules/CPA2005/8_Form_IFP.pdf. Schedule A lists debtor's real property; Schedule B, which now has thirty-five questions, lists debtor's personal property; Schedules I and J are the "real" current income and expenditures.

[44] Pub. L. No. 109-8, § 716(b)(1), 119 Stat. 23, 129 (to be codified at 11 U.S.C. § 1308(a)).

[45] *Id.* § 716(b)(1), 119 Stat. at 129–30, 11 U.S.C. § 1308(b).

[46] *Id.* § 716(c), 119 Stat. at 130 (to be codified at 11 U.S.C. § 1307(e)).

filed in order for a Chapter 13 plan to be confirmed.[47]

On request of a party in interest or the court, a Chapter 13 debtor must file annual statements of the debtor's income and expenditures for the tax year concluded, and the monthly income of the debtor with a breakdown of the calculations.[48]

Financially stressed low-income persons who have recently undergone a period such as a divorce, illness, or natural disaster—a period in which they may not have been able to keep good records—are still subject to these requirements. While a debtor may request a short extension to gather some of the information, the debtor needs much of the basic financial information to structure an appropriate Chapter 13 plan since the plan details the debtor's proposal to pay to his creditors the portion of the debt that he can. [49]

### B. Longer and Costlier Plans

To be confirmed, many Chapter 13 plans must be longer and costlier. The Chapter 13 debtor has to propose to make payments of her disposable income to the Chapter 13 trustee for longer specified periods. Debtors also have to pay more for secured collateral that they wish to retain.

Debtors with "current monthly income" (as specified in Sections 707(b)(2)(A) and (B)) at or over the applicable median income must now propose a five-year plan.[50] Low-income persons filing Chapter 13 likely will not be subject to this requirement. In order to qualify, low-income clients needing to file Chapter 13 must demonstrate a sufficient amount of disposable income for the plan duration to cover administration costs and attorney fees, in addition to claims that must be paid.

The ability to restructure secured claims has been further restricted. A Chapter 13 debtor formerly could take a debt, such as that for a car loan, and propose to pay through the plan a differing amount, typically less, than that due under the car contract. Under the new code, if the plan proposing to keep such a car is not accepted by the creditor, the plan must (1) allow the claimant to hold the lien on the vehicle until the amount due under the contract is paid or the case is completed and (2) set forth equal payments providing "adequate protection" to the creditor during the period of the plan.[51] Even if the plan bifurcates the claim of a secured creditor, the plan must often provide for the "replacement value" of the collateral with interest.[52] The replacement value is typically the amount that a retail merchant, considering the collateral's age and condition, would charge for the collateral. Depending on how this definition is applied, the replacement value could be greater than the actual "fair market value" of an item.[53]

The key amendment regarding the ability to restructure, or "cram down," certain secured debt appears immediately after Section 1325(a)(9). The amendment provides that 11 U.S.C. § 506 does not apply to a purchase money security interest in a motor vehicle acquired for personal use and within the 910-day period prior to the filing of the case.[54] Section 506 bifurcates secured debts into a secured portion equal to the actual value of the collateral and an unsecured por-

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[47] *Id.* § 716(a), 119 Stat. at 129 (to be codified at 11 U.S.C. § 1325(a)(9)).

[48] *Id.* § 315(b), 119 Stat. at 91 (to be codified at 11 U.S.C. § 521(f)(4)).

[49] 11 U.S.C. §§ 1321–1322, 1325 (2000) (extension).

[50] Pub. L. No. 109-8, § 318(3), 119 Stat. 23, 93–94 (to be codified at 11 U.S.C. § 1325(b)(4)(A)(ii)).

[51] *Id.* § 306(a), 119 Stat. at 80 (to be codified at 11 U.S.C. § 1325(a)(5)(B)); *Id.* § 309(c)(2), 119 Stat. at 83–84 (to be codified at 11 U.S.C. §1326(a)).

[52] *Id.* § 327, 119 Stat. at 99–100 (to be codified at 11 U.S.C. § 506(a)(2)).

[53] *Id.* Cf. *Associates Commercial Corporation v. Rash,* 520 U.S. 953 (1997).

[54] Pub. L. No. 109-8, § 306(b), 119 Stat. 23, 80 (to be codified following 11 U.S.C. § 1325(a)(9)).

tion for the remaining balance. If Section 506 does not apply, and the debtor may not split the debt in this way, he may have to pay more than what the vehicle is worth in order to keep it. The new provision also prohibits bifurcation of secured claims based on purchase money security interests for any other thing of value purchased within the one-year period prior to the filing of the case. The net effect of the amendments regarding cram-down is that many debtors either will have to pay more to keep their vehicles or other personal property or will have to surrender these items. However, debtors may still be able to reduce the interest rate paid, which can be a significant benefit for debtors paying "eye-popping" interest rates.[55]

### C. Fewer Debts Discharged

The revised law scales back the value of the discharge in Chapter 13 cases. For certain debtors, this may reduce the incentive for completing or filing a Chapter 13 case. Debtors should evaluate carefully the value of a discharge before filing a case.

Previously one of the great benefits in completing a Chapter 13 case was the broader discharge of debts granted under Section 1328(a), compared to the more limited discharge of debts under Chapter 7, Chapter 11, Chapter 12, or, in a hardship situation, Section 1328(b) of Chapter 13. The categories of nondischargeable debts under the amended Section 1328(a) are significantly expanded.

Former Section 1328(a) excluded from discharge long-term debts, where the final payment was due after the last payment due under the plan; alimony and child support; student loans; death or personal injury debts due to drunk driving; and criminal restitution or fines. The list of nondischargeable debts in the amended Section 1328(a) is expanded to include debts arising from withholding taxes; unfiled or late-filed tax returns; fraudulent or willful evasion of taxes; debts incurred by fraud; unlisted debts; debts resulting from embezzlement, theft, or fraud while acting in a fiduciary capacity; domestic support obligations (as defined under the new code); student loans (under an expanded definition); and civil restitution or damages for willful or malicious acts causing personal injury or death.[56] Debtors with the foregoing type of debt may not discharge the balance, or interest and penalties, even after the plan is completed.

If a debt is not dischargeable, the general rule is that interest and other penalties continue to accrue while a bankruptcy is pending. A potentially positive change for persons liable for an unsecured claim nondischargeable under Section 1328(a) is that the Bankruptcy Code now explicitly allows such persons to provide for payment of interest on such claims in their Chapter 13 plans.[57] The ability to pay interest on such claims allows debtors to address the substantial accumulation of interest during the course of the bankruptcy plan. However, the new section permits the debtor to pay interest on such claims only if the plan provides for full payment of claims approved for payment in the case.[58] As the financial resources of persons in Chapter 13 are already stretched thin, whether many persons can take advantage of this section is unclear.[59] Debtors' attorneys should continue to explore the argument

[55] *In re Till*, 301 F.3d 583, 593 (Rovner, J., dissenting), rev'd sub nom. *Till v. SCS Credit Corporation*, 541 U.S. 465 (2004) (Clearinghouse No. 55,673). The contract interest rate in *Till* was 21 percent; many low-income debtors routinely pay interest rates far in excess of that.

[56] Pub. L. No. 109-8, §§ 314(b), 707, 119 Stat. 23, 88, 126 (to be codified at 11 U.S.C. § 1328(a)).

[57] *Id.* §§ 213(9), 314(b), 119 Stat. at 53, 88 (to be codified at 11 U.S.C. §§ 1322(b)(10), 1328(a).

[58] *Id.* § 213(9), 119 Stat. at 53 (to be codified at 11 U.S.C. § 1322(b)(10)).

[59] Aside from the limited effectiveness of the new provision on interest on nondischargeable claims, the problem of nonbankruptcy penalties other than interest that continue to accrue against nondischargeable debts remains, as does the question of the proper application of payments received while the bankruptcy case is proceeding. See, e.g., *Kielisch v. Educational Credit Management Corporation (In re Kielisch)*, 258 F.3d 315 (4th Cir. 2001) (allowing student loan creditor to apply bankruptcy payments in manner prescribed by nonbankruptcy law notwithstanding Chapter 13 claim and plan).

that a Chapter 13 plan may propose different treatment for nondischargeable claims from other general unsecured claims in order to remedy the harsh impact of interest and penalties that remain on such claims after the completion of the plan.[60]

The new Section 1328(f) further restricts discharge: the court may not grant a discharge if the debtor received a discharge in a case filed under Chapter 7, 11, or 12 within the past four years from the date of the order of relief or, in a case filed under Chapter 13, within the past two years from the date of such order.[61] Chapter 13 debtors must also now complete a course in "personal financial management" before being granted a discharge, even though their successful completion of a plan may indicate that they have learned the lessons that such a course may teach.[62]

## IV. Conclusion

The new credit-counseling requirement and the need to supply extensive financial documentation may make timely relief under Chapter 7 or Chapter 13 impossible for persons in an emergency situation. The burden of complying with all of the new requirements may effectively prevent a low-income or financially stressed client from getting an appropriate case filed or approved at all.

Low-income clients in particular may be more prone to wait too long to address a serious situation due to lack of understanding or means. To minimize the adverse effects of these code changes, attorneys must get word out to affected client communities that bankruptcy is still available but can no longer be a last-minute decision. Once the client contacts them, attorneys need to work efficiently and creatively to help their clients meet all of the new requirements if filing under Chapter 7 or Chapter 13 is appropriate.

Navigating all the complex provisions of the Bankruptcy Code without an attorney was difficult before. It is nearly impossible now. Legal aid programs that have excluded some or all bankruptcy cases from their priorities because clients could file *pro se* or afford a private attorney should consider expanding the services that they offer in this area. And attorneys willing to represent clients pro bono are now an even more valuable resource for low-income debtors.

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[60] See, e.g., *In re Belda*, 315 B.R. 477 (N.D. Ill. 2004) (reversing order confirming Chapter 13 plan of reorganization where the plan that maintained regular payments to student loan creditor would generate higher dividend of payments to student loan than to general unsecured creditors), appeal dismissed on other grounds, No. 04-3820 (7th Cir. July 26, 2005).

[61] The date of the "order for relief" is the date the petition was filed, except in involuntary bankruptcy cases. 11 U.S.C. §§ 301–302(a) (2000).

[62] *Id.* § 106(c), 119 Stat. at 38 (to be codified at 11 U.S.C. § 1328(g)).