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LAWYERS PREPARE FOR BANKRUPTCY CHANGE (Published July 2, 2005, in the Columbia Business Times) - 7/2/2005

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LAWYERS PREPARE FOR BANKRUPTCY CHANGE

COLUMBIA, Mo. – While local lawyers and their clients scramble to prepare bankruptcies under the old statutes before the new bankruptcy law takes effect, a study indicates that the new law may hammer small businesses.

President George W. Bush signed the 500-page Bankruptcy Abuse Prevention and Consumer Protection Act into law April 20 – on Hitler’s birthday, critics note sardonically – saying that people have abused the bankruptcy laws in recent years.

“Under the old system, there were higher-income people who were using the bankruptcy system as a financial planning tool, who were entering into bankruptcy still having significant income, and then choosing Chapter 7 bankruptcy to discharge all their debts,” said Laura Fisher, spokesperson for the American Bankers Association. “What the new system will do is instill the principle that if you can afford to repay some of your debts, you should be required to do so.”

Opponents say the new law favors the wealthy over the poor, single mothers and senior citizens, and the new study suggests it will also erase the small entrepreneur’s safety net and dampen the formation of new businesses.

“I’ve been living with this disaster for a while; it’s scary, really scary, from my point of view,” said Gwen Froeschner Hart, owner of Shurtleff, Froeschner and Bunn LLC in Columbia. “It prohibits entirely some people from filing bankruptcy, and it’s going to force a lot of people who in the past were able to file a Chapter 7, which is the cheapest, quickest, in-and-out form of bankruptcy...into a Chapter 13, where you have to make payments on your debt.”

Supported by banks and credit card companies, the new law takes effect in October. Bankruptcy filers will have to pass a means test based on IRS guidelines to decide whether those declaring bankruptcy will have to file under more stringent Chapter 13 rules rather than more lenient Chapter 7 rules.

Any filer who makes less than his or her state’s median income, about \$54,000 nationally for a family of four, will automatically qualify for Chapter 7 bankruptcy, Fisher said. A filer with a

family income greater than the state median would then have to pass a needs test comparing family income to expenses, including such items as daily living expenses, car or home payments, and child support. If the filer's income is about \$100 greater than expenses, he or she may have to choose Chapter 13, which means entering a payment plan imposed by the court instead of having the debts erased. The filer then can argue to the court that he or she cannot complete a repayment plan because of a significant medical condition, a sudden cut in income such as one from service in the military reserve.

"If someone can't follow a repayment plan, there's no reason to put them on one," Fisher said. "There's no reason to go through the court to monitor the plan and the creditors to agree to the plan if they know the person can't follow it."

Although Fisher said adjustments would be factored in for local costs in particular cities, lawyers still question the use of IRS averages to calculate "reasonable monthly living expenses." "That's going to be based not on your actual monthly living expenses, but on the IRS means test, what they say is average," Hart said. "People who are paying more rent than average; they're not going to get credit for that. If they're eating more food than average, they're not going to get credit for that. If they live someplace where the utilities are extremely high, they're not going to get credit for that."

A filer with an adjustable rate mortgage might have to renegotiate such changing costs with the creditor, most often converting to a fixed-rate mortgage, with the consent of the court. "The court's discretion is involved," Fisher said. "The obvious preferable outcome is that people follow their repayment plans and make their payments. It's not that you rope people into a payment plan they can't follow."

However, a study published in the California Law Review by law professors Robert Lawless at the University of Nevada-Las Vegas and Elizabeth Warren at Harvard and funded by the Ewing Marion Kauffman Foundation in Kansas City, found that government tracking of bankruptcies failed to count between 220,000 and 280,000 filings by entrepreneurs, self-employed individuals and independent contractors. While the Administrative Office of the U.S. Courts claims only 2.3 percent of 2003 bankruptcies were business-related, about 37,000, the professors say the number is as high as 17.4 percent, estimating 260,000 to 315,000 bankruptcies.

The study suggests the new law may squelch the drive to create new businesses, discouraging entrepreneurs from taking risks. "Down through history, a lot of people have started businesses and failed, and a lot of people who have bankruptcy problems are because of business problems," Hart said. "That's not going to be so easy to walk away from anymore."

Bankruptcies nearly doubled between 1995 and 2004, according to Nolo, a legal resource company. Government statistics show that business bankruptcies began to decline steadily in the mid-1980s, from about 18 percent of all bankruptcy filings to 2 percent today. However, because of the way new small businesses are recorded, corporations and similar legal entities make up almost all of the bankruptcy filings counted by government today. The UNLV-Harvard professors blame the discrepancy on faulty reporting from efforts in the 1980s to simplify reporting and new software that changed the way attorneys completed forms to compile the statistics that tended to classify small business cases as consumer cases.

Lawyers predict that the new law will cause fees to skyrocket because of increased paperwork and new mandates that lawyers verify client income and monitor their clients' attendance in financial education courses. "It was a real one-sided law, and attorney's fees will go up as a result," said Columbia lawyer Mitch Moore, predicting that fees would rise on average from a range of \$500 - \$1,000 to \$800-\$2,000.

Lawyers also complain about irresponsible marketing by credit card companies. During the same time period that bankruptcies were doubling, credit card company profits tripled, said Hart.

"As soon as [my clients] file for bankruptcy, they get more [credit card] offers," Moore

said.

Still, Fisher said most people would feel no effects from the bankruptcy bill and that it is only targeted at the 5 to 10 percent of people who go into bankruptcy to pay their debts, but simply don't want to pay them.

"It's basically what's fair," Fisher said. "If you do have the means to pay some of your debt, you should pay it. It's common sense."

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