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## **LAWYERS PREPARE FOR NEW BANKRUPTCY LAW (Published in the August 2005 Jefferson City Business Times) - 8/1/2005**

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### **LAWYERS PREPARE FOR NEW BANKRUPTCY LAW**

By Jim Muench

While local lawyers and their clients scramble to prepare bankruptcies before the new bankruptcy law comes into play, a study indicates that the changes in the code may hammer small businesses.

Supported by banks and credit card companies, the new law takes effect in October. President George W. Bush said when he signed the 500 - page Bankruptcy Abuse Prevention and Consumer Protection Act 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.

The objective behind the new code is to prevent people from filing for bankruptcy by making it more expensive and burdensome, said Neal Bisges, a Jefferson City attorney. "I would say [the changes] are absurd," Bisges said. "I would parallel this to saying that 'there are no cancer victims because we have now decided not to do radiation treatments.' And it parallels that 'there are no financial problems because we are not going to file bankruptcies.'"

Bankruptcy filers will have to pass a means test based on Internal Revenue Service guidelines to decide whether those declaring bankruptcy will have to file under more stringent Chapter 13 rules rather than more lenient Chapter 7 rules. Reed said he believes the means test will not affect most central Missourians filing for bankruptcy.

Any filer who makes less than his or her state's median income — \$59,764 for a family of four in Missouri — 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 \$100 greater than expenses or more, 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.

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."

"The IRS expenses basically doesn't consider the individual situations; nor does it consider the general group of expenses that are actually incurred," Bisges said. "There are people who are poor that receive public assistance, and those underlying expenses do not consider low-income people who receive public assistance. It just doesn't consider the expenses that people actually have."

"If you want to file a Chapter 7, you are going to have to prove to the court that it's appropriate that you file a Chapter 7, and then there are even some sanctions on attorneys if they file a Chapter 7 and the court denies it," said John Reed, an attorney in Jefferson City. "We don't know how the courts are going to interpret that and when they are going to sanction, but it's just another worry for a debtor's counsel."

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 funded by the Ewing Marion Kauffman Foundation in Kansas City and published in the *California Law Review*, [ital] found that government tracking of bankruptcies failed to count between 220,000 and 280,000 filings by entrepreneurs, self - employed individuals and independent contractors. Although the Administrative Office of the U.S. Courts claims only about 37,000, or 2.3 percent of 2003 bankruptcies were business - related, the study's authors — law professors Robert Lawless at the University of Nevada - Las Vegas and Elizabeth Warren at Harvard — 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. "It will definitely discourage people from starting new businesses or entrepreneurial activities because it is unforgiving," Bisges said. "It's very pro-creditor and anti-business."

In fact, Missouri is probably the worst state for businesses to start because it is one of the toughest states for businesses that get into credit trouble, Bisges said. The state is one of only a few that do not exempt Federal assistance, encourages predatory lending through weak usury laws and only allows a \$15,000 homestead exemption, one of the lowest in the nation.

"Missourians should write their state representatives to eliminate usurious lending, increase exemptions and consumer protections," he said. "When somebody goes into business they can

lose everything.”

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. Lawless and Warren 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.

“Most of these Chapter 13 plans will be five years, not three years, so imagine you are on a tight budget for five years; it’s just hard,” Reed said. “If someone truly is in a bad situation, and has substantially more credit card debt than they can ever hope to repay, there aren’t a whole lot of options out there besides bankruptcy. So it may be that we will still have the same number of bankruptcies going on. We just don’t know exactly what the impact is going to be.”

Lawyers predict that the new law will cause fees to increase significantly, perhaps double, because of increased paperwork and new mandates that lawyers verify client income and monitor their clients’ attendance in financial education courses.

“There’s just more paperwork that has to be done, and if it isn’t done, the case gets dismissed, and it’s a lot more burdensome,” Bisges said. “By raising the cost, they’re probably going to eliminate 20 percent of the people who could and would file bankruptcy simply because they cannot afford the attorney fees involved.”

Lawyers also complain about irresponsible marketing by credit card companies, noting that during the same time period in which bankruptcies were doubling, credit card company profits tripled. They say their clients often get credit card offers as soon as they declare bankruptcy.

“This is a very common occurrence; almost every client gets two or three pre-approved credit card applications,” Bisges said. “Those [barbarian hordes] that you see on TV with Capital One... they’re real. The new bankruptcy bill sets up a modern-day debtors prison. You won’t be raped and pillaged by creditors who garnish you, but you, your wife and your family will have less as creditors continue to fee and charge you beyond your ability to pay.”

Still, Fisher said most people would feel no effects from the bankruptcy bill; it is only targeted at the 5 percent 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.”

Bisges sees a negative ripple effect across the economy due to the bankruptcy changes.

“Strangely enough, bankruptcy allows somebody to basically start charging consumer goods versus continuing to pay finance charges, and I think it translates into real economy stagnation if you don’t allow somebody to start over, he said.”

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