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CONSUMER NEWS

By Douglas C. Nelson*

A New Chapter in Consumer Bankruptcy Law

Bankruptcy is essentially a process by which a consumer may eliminate debt or establish a favorable repayment plan as a way to get out from under overwhelming debt.¹ But, of course, millions of consumers already knew that. In 2004, consumer debt in the United States reached \$1.7 trillion—a new high.² During the same period, more than 1.5 million U.S. consumers filed for bankruptcy protection.³ That is approximately one in every seventy-three U.S. households.⁴

Not surprisingly, Congress responded with the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which will soon make it more difficult for consumers to walk away from their debts.⁵ Under the former consumer bankruptcy laws, seventy percent of consumers who filed for bankruptcy were able to eliminate credit card debt, medical expenses, and utility bills.⁶ Chapter 7 of the bankruptcy code⁷ is the provision that essentially allows consumer-

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¹ Shirley Dean, *CONTRA COSTA TIMES*, May 21, 2005, at F4.

² *Id.*

³ *Id.*

⁴ Terry Savage, *Many New Changes in Bankruptcy Laws*, *CHI. SUN-TIMES*, Apr. 25, 2005, at 65.

⁵ Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005); Marianne Lavelle, *When You're Down and Out*, *U.S. NEWS & WORLD REPORT*, Mar. 14, 2005, at 18.

⁶ Lavelle, *supra* note 5, at 18.

⁷ 11 U.S.C.A. ch. 7 (West 2005).

debtors to “wipe the slate clean” as to most types of debt.⁸

While Chapter 7 will still work its magic for some consumer-debtors, under the new law, many filers will no longer qualify for Chapter 7 protection, and will be channeled to a new and less forgiving chapter of the bankruptcy code—Chapter 13.⁹ Under this chapter, filers who have a sufficient income will be required to repay creditors in small monthly amounts over a five-year period according to a court-ordered repayment schedule.¹⁰

But just what constitutes a sufficient income is a question that is expected to keep bankruptcy lawyers busy, potentially increasing the attorney’s fees that bankrupt consumers will pay.¹¹ Essentially, the “means test” formula goes like this: if a consumer’s income is over the annual household median for their state *and* the court determines that he or she can make payments of at least \$100 per month after paying for living expenses, then the consumer may only file under Chapter 13.¹² While the formula sounds straightforward enough, the devil is likely to be found in the details as lawyers and courts attempt to determine and apply living expenses for essentials such as food, housing, clothing, personal care, and transportation.¹³

In addition to the extra legal work this Act is likely to generate, the law has also drawn criticism from consumer-advocacy groups who are quick to point out the real winners here are the credit card companies.¹⁴ Indeed, the credit card industry has reportedly donated \$24.8 million to federal politicians since 1999.¹⁵ As one lawmaker put it, “This [law] puts credit card companies and banks at the head of the list.”¹⁶

⁸ Lavelle, *supra* note 5, at 18. Chapter 7 does not permit filers to escape back taxes, alimony, child support, or student loans. *Id.*

⁹ 11 U.S.C.A. ch. 7 (West 2005); Lorene Yue, *Bankruptcy Reform Toughens Consumers’ Exit From Debt*, CHI. TRIB., Mar. 27, 2005, at B1.

¹⁰ Lavelle, *supra* note 5, at 18.

¹¹ Yue, *supra* note 9, at B1.

¹² *Id.*

¹³ *Id.*

¹⁴ *Bankruptcy Bill on Fast Track*, 18 Credit Card Mgmt. 8, Apr. 1, 2005, available at 2005 WLNR 5104698.

¹⁵ *Id.* MBNA Corp., is the leading political contributor, donating \$6.7 million to candidates—including President Bush—since 1999. *Id.* The American Bankers Association has donated over \$5.8 million during this same timeframe. *Id.*

¹⁶ *Id.* (quoting Representative Jan Schakowsky (D-Ill.)).

While “bankruptcy” may conjure up images of irresponsible consumers living beyond their means, studies have shown that consumers often find themselves seeking bankruptcy relief after unforeseen medical expenses, losing their job, or divorce.¹⁷ This provision will make it that much harder for cash-strapped consumers—the unfortunate and irresponsible alike—to move on with their lives and put their debts behind them.¹⁸

Furthermore, although declaring bankruptcy allows consumers to get out from under overwhelming debt, bankruptcy—even prior to this bill—is not a free pass for consumers.¹⁹ A bankruptcy filing remains on a consumer’s credit report for seven to ten years, and may prevent an individual from getting a job, being promoted, or being able to do something as basic as renting an apartment.²⁰ Also, it must be remembered that consumers may not use bankruptcy to discharge certain debts, including: back taxes accrued less than three years earlier, student loans, alimony payments, and child support payments.²¹

In addition to the “means test,” the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, provides that consumers who have equity in their homes will only be able keep up to \$125,000 of that equity away from creditors.²² However, where state laws provide for greater exemptions, state law will apply provided the bankrupt consumer has lived in that state for at least forty months prior to filing.²³

Other features of the Act include mandatory credit counseling and a fraud prevention provision. Consumers who wish to file bankruptcy will need to attend at least six months of credit counseling before filing for bankruptcy protection,²⁴ and will not be able to have their debts discharged until completing a court approved

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ Dean, *supra* note 1, at F4; *see also* Consumer Action, at www.consumer-action.org (suggesting alternatives to financial management to avoid the undesirable consequences of filing for bankruptcy protection).

²⁰ Dean, *supra* note 1, at F4.

²¹ *Id.*

²² Savage, *supra* note 4, at 65.

²³ Brian Collins, *Bankruptcy Bill May Pass*, ORIGINATION NEWS, Apr. 1, 2005, at 716.

²⁴ Yue, *supra* note 9, at B1.

personal financial management course.²⁵ The Act's "fraud test" provision will prevent consumers from escaping payments on goods or services the court determines to be "luxury items" purchased for over \$500 with a credit card within ninety days of filing for bankruptcy.²⁶

Notably absent from the Act are measures to prevent predatory lending practices, such as excessively high interest rates on credit cards, that take advantage of consumers struggling with their finances and helps drive consumers into bankruptcy in the first place.²⁷ The Federal Trade Commission has recently had its hands full with bogus debt management companies that promise to reduce a consumer's debt while delivering only higher interest rates and penalties.²⁸ While some lawmakers attempted to include predatory lending provisions in the Act, these provisions were left out and have now been proposed in a separate bill.²⁹

There must be limits to the forgiveness lawmakers are willing to extend to consumers who have failed to adequately manage their finances. But bankruptcy relief must also be made available to give down-and-out consumers a chance to rebuild their lives and provide for their families. While, arguably, the Act, strikes as balance between the interests of consumers and consumer lenders, this new chapter in bankruptcy law is undeniably a win for lenders.³⁰

²⁵ Yue, *supra* note 9, at B1. It is somewhat ironic to note that the required personal financial management course will cause indebted consumers approximately \$25-\$50 a month. *Id.*

²⁶ *Id.*

²⁷ Editorial, *PHI. DAILY NEWS*, Mar. 31, 2005, at 16.

²⁸ *FTC Cracks Down on Bogus Debt-Settlement Companies*, *CARDLINE*, Apr. 1, 2005, at 1 (reporting that three credit counseling companies have recently settled with the Federal Trade Commission: National Consumer Counsel, Better Budget Financial Services, and Debt Management Foundation Services agreed to pay \$6 million in restitution, with \$124 in penalties ordered, but suspended).

²⁹ Collins, *supra* note 23, at 716. Senators Bob Ney (R-Ohio) and Paul Kanjorski (D-Pa.) introduced a bill intended to reduce predatory lending shortly after the Senate approved the consumer bankruptcy bill. *Id.* This bill contains provisions similar to the amendments that were rejected in the bankruptcy bill, in part, because Senators wanted to limit the scope of the bankruptcy bill and considered the predatory lending provisions to be misplaced. *Id.*

³⁰ *Bankruptcy Bill on Fast Track*, *supra* note 14 (quoting Senator Charles Grassley (R-Iowa), "This [the passage of the Act] proves if you are right on something, you can win. We are right on this.").