

Consumers can still file for bankruptcy, but it's harder now

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A little over two years since the enactment of a landmark bankruptcy reform law, debt-strapped consumers are finding it tougher to wipe out their bills.

"It's gone from something where those who are really struggling could say, 'I can look at it and do that' to something that is much more daunting," said Henry J. Sommer, president of the National Association of Consumer Bankruptcy Attorneys.

Contrary to what some consumers believe, the law didn't eliminate bankruptcy. It's still available to those who truly can't pay their bills and need to start over. But you should decide whether to file for bankruptcy only after consulting with a credit counselor and an attorney.

"It's a very serious decision," said Jay Westbrook, a bankruptcy expert and the chair of business law at the University of Texas School of Law. "You shouldn't do it unless you have to, but if your situation is one where your debt is genuinely unpayable, bankruptcy is there to get you out of a situation where your debt is realistically unpayable."

That was the case for John Ross, a junior high school teacher in Wills Point in Van Zandt County. Divorce caused him to file for bankruptcy and liquidation of his unsecured debts last year.

"I was strapped with so much debt," Mr. Ross said. "I was doing everything I could to make the minimum payments, and I just couldn't do it as a single dad of three. I hated having to admit that I couldn't pay them what I promised them."

Congress passed the bankruptcy reform law after a decade of debate.

The lending industry argued that it was too easy for people to wipe away their credit card debts without penalty. Consumer advocates countered that aggressive lenders were partly to blame and that bankruptcy laws must continue to protect down-on-their-luck Americans and give them a fresh financial start.

The result is a more restrictive law designed to push more bankruptcy filers to repay at least some of their debts under Chapter 13 of the U.S. Bankruptcy Code rather than having most of their debts wiped away under Chapter 7.

"Prior to this new law, people who could pay some of their debt were not paying any of it by going into Chapter 7," said Steve Bartlett, chief executive of the Financial Services Roundtable, which represents financial services companies. "Bankruptcy is not for people who can pay their

bills."

Debtors who can pay some of their bills should be expected to do so, he said. "That's the intent of the law, and that's what's happened."

In congressional testimony in October, the American Bankers Association said consumer bankruptcy filings had fallen to roughly half of what they were before the bankruptcy reform law took effect on Oct. 17, 2005.

"This is evidence that borrowers are, in fact, employing alternatives to bankruptcy," the bankers group said. "It also indicates that debtors are reaching out to lenders to try and negotiate workable repayment plans."

Since the enactment of the new bankruptcy law, Chapter 7 filings also have fallen compared with Chapter 13 filings, the bankers group said.

In the years leading up to the enactment of the law, "the share of Chapter 7 filings was nearly 73 percent," the association said. "Since enactment of the new law, that share has fallen to just over 60 percent."

In evaluating bankruptcy filings, the pig-in-the-python effect that occurred in 2005 must be factored in.

That year, America's bankruptcy courts were buried in filings by hundreds of thousands of debtors hurrying to beat the clock before the new law took effect.

Consumer bankruptcy filings soared 30 percent to 2 million nationally in 2005, including 117,612 in Texas.

Then they fell off the map.

Nationally, consumer bankruptcies in 2006 plummeted 70.7 percent from 2005, according to the Administrative Office of the U.S. Courts.

Texas filings nose-dived 71 percent in 2006 from 2005.

In 2007, consumer bankruptcy filings jumped nearly 35 percent nationwide from 2006, but they remain below 2005 levels, according to the American Bankruptcy Institute, a nonpartisan organization that studies bankruptcy issues.

Consumer bankruptcy filings in the U.S. Bankruptcy Court's Dallas-based Northern District of Texas have followed the same trend.

The slowing economy, job losses, and the housing and credit crisis are sure to feed more bankruptcies, experts said.

"They will continue to go up because the economy is going into the ditch," Mr. Westbrook said.

Bankruptcy experts said there are several reasons why bankruptcy filings went down under the new law. They indicate the increased challenges that debtors face in trying to regain financial health.

"By far the biggest effect is that it's raised the cost of bankruptcy very substantially -- by 50 to 100 percent," said Mr. Sommer, the consumer bankruptcy attorney leader. "Attorney fees have gone up 50 to 100 percent."

That's because of more paperwork on short deadlines and increased liability for lawyers. Court filing fees also have increased.

"Bankruptcy is just flat far more complicated and far more expensive," said Charles Chesnutt, an Addison bankruptcy lawyer. "I've had to change the way I work because the additional requirements make it far more difficult to properly do a bankruptcy."

Mr. Ross, his client, said, "The law really caused me to go through a lot of paperwork to make sure I qualified every step of the way."

Contrary to what some may believe, the new law's income test hasn't emerged as the main roadblock to bankruptcy, experts said.

The test requires anyone with income above a state's median income to file for Chapter 13.

"It's not having that much effect because there were never that many people who could afford to pay their debts [in bankruptcy], and the means test has just proven that," Mr. Sommer said. "Most people were not living high on the hog."

Some consumers believe that bankruptcy is no longer available to anyone, attorneys said.

"If someone qualifies for it, they should be allowed, as long as they've exhausted every avenue," Mr. Ross said.

The bankruptcy law requires debtors to undergo credit counseling before filing for bankruptcy.

When meeting with a financial counselor or a bankruptcy attorney, be honest about your financial situation.

"It really depends on how easily you can pay these creditors off," Mr. Chesnutt said. "If you think you can pay them off in five years or less, then you may consider not filing bankruptcy. If you can't pay it, you should consider bankruptcy."

Keep in mind, though, that bankruptcy has consequences.

"Their next-door neighbor who filed bankruptcy may appear to be living large, but at what

price?" said Gail Cunningham, spokeswoman for the National Foundation for Credit Counseling. "Yes, after bankruptcy a consumer will be offered credit, but the interest rate is likely to be much higher than what someone with a solid credit score would have."

A bankruptcy also can remain on your credit report for up to a decade.

Legislation pending in Congress could change bankruptcy laws further.

The legislation would allow bankruptcy judges to alter the terms of a mortgage on a debtor's principal home.

Lenders oppose the proposal, saying it would raise mortgage payments for consumers by allowing courts to write down the value of home mortgages in the event of bankruptcy by the borrower.

"To account for the new risk that this bill imposes, lenders will be forced to require higher down payments, higher costs at closing and higher interest rates," the Mortgage Bankers Association said in a statement.

Holding all else constant, the association said the proposed change would increase interest rates on all future mortgages by 1 1/2 to 2 percentage points.

"The last thing homeowners need in this market is higher mortgage payments," said David Kittle, chairman-elect of the mortgage bankers group.