

Filings are fewer, but is that good?

A year into new bankruptcy law, debate rages

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By PAMELA YIP / The Dallas Morning News

One year ago today, America's bankruptcy courts were buried in filings by hundreds of thousands of debtors hurrying to beat the clock before a more restrictive law went into effect.



Milton Hinnant / DMN

Charles and Carolyn Chesnutt are Addison-based bankruptcy lawyers. Debtors and their attorneys now have to make sure the paperwork is right the first time. 'You may not be able to do it again,' he says.

Since Oct. 17, 2005, the number of filings is way down, at least in part because so many people accelerated their cases to be considered under the old law.

A year later, there's still debate about the fairness of the new law and whether it's working to reduce bankruptcy filings as intended.

"The feeling is that so far, it's a success," said Laura Fisher, spokeswoman for the American Bankers Association. "Some of the abuse has been wrung out of the system."

But Ike Shulman, former president of the National Association of Consumer Bankruptcy Attorneys, said: "Compared with what the credit industry claimed they could accomplish, it's pretty much been a bust."

Congress passed the 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, while consumer advocates countered that aggressive lenders were partly to blame and that bankruptcy laws must continue to protect down-on-their-luck Americans from a life of indebted servitude.

The main provision of the law is an income test and other measures designed to push more bankruptcy filers to repay at least some of their debts in Chapter 13 rather than having all their debts wiped away in Chapter 7.

But that measure is having little effect, bankruptcy attorneys and credit experts said.

"Abusers were always a very small part of that population," said Samuel J. Gerdano, executive director of the American Bankruptcy Institute in Alexandria, Va., a nonpartisan organization. "Our study that we funded in the late '90s showed only about 3 percent of the Chapter 7 population even had the ability to fund a repayment plan. That still holds today."

A survey by the bankruptcy attorneys group found that less than a third of bankruptcy attorneys are seeing an increase in forced Chapter 13 repayment filings. Fewer than one in 20 reported a major increase.

Tapped out

The new law also requires debtors to undergo credit counseling before they file for bankruptcy, with the hope that they can work out their debts without filing.

Credit counselors said they're not seeing much success along those lines.

"We're looking at between 3 and 6 percent who are being converted to our debt management plan," said Bonnie Peterson, director of education and marketing at Consumer Credit Counseling Service of North Central Texas. "The rest are just upside down way too much to be able to pay it back."

That's a consistent trend nationwide, said Susan C. Keating, chief executive of the National Foundation for Credit Counseling.

"We believe these people are in serious financial trouble. We don't believe these are people who are trying to game the system."

That's because most debtors are tapped out, said Howard Marc Spector, a Dallas bankruptcy attorney.

"After you get done paying your mortgage, paying your car, most people don't have any money left, so therefore most people, when they take the means test, don't have any disposable income that would require them to file a Chapter 13," he said.

More paperwork

The law, which represented the most sweeping reform of bankruptcy laws in a quarter-century, created several other hurdles for debtors and their attorneys.

As a result, bankruptcy attorney's fees have jumped between 60 percent and 100 percent, said Mr. Shulman of the attorney's group.

Paperwork has increased, thanks to the income test. Attorneys have to attest to the truthfulness of the documents.

And attorneys are prohibited from advising a client to take on additional debt before a bankruptcy filing, although that provision is being challenged as unconstitutional.

Debtors and their attorneys also have to ensure that they get their paperwork done right the first time.

"If you don't, you may not be able to do it again," said Charles Chesnutt, an Addison bankruptcy attorney. "The new law makes the dismissal of a case automatic if the right papers are not filed at the right time."

In the bankruptcy reform law, lenders "got everything they wanted, and the consumers got nothing," said Carolyn Chesnutt, who practices with her husband. "The credit card companies wrote the bill, pushed it through and turned Chapter 13 into their own private debt collection agency."

One of the Chesnutts' clients, a Dallas County woman who asked not to be named, said Mr. Chesnutt explained the new realities very clearly.

"It's very scary at first," she said. "He lays out the laws to you in a way like, 'you'd better tell the truth and don't hold back nothing.' I'm like, 'Tell it all, tell it all.' "

Making the cut

Her case is typical of the consumers who file for bankruptcy, most of whom blame illness, divorce or a job loss for their filing.

She said her case was triggered by the costs of caring for her husband, who became paralyzed from the neck down by a rare disease.

"He's been disabled for four years," said the woman, 47, a postal clerk. "For four years, I've been trying to hold on to everything I have, and I couldn't."

When her husband became ill, she wasn't at her job long enough to be covered by health insurance. Now she has health insurance, but her husband can't be put on her policy, because he has a pre-existing catastrophic condition.

She worried at first that she wouldn't make the cut under the means test for filing for Chapter 7.

"I wondered what we would have to do to qualify, but I felt that a catastrophic illness would not knock me out of the running," said the woman, who filed last month with \$60,000 in debt.

Despite the tougher laws, the bankruptcy system is working for her.

"It's a relief that all the pressures are not on me," she said.

There's no doubt that the passing of the bankruptcy law has reduced filings this year.

"We're on track for about 600,000 filings for the year, and that's a mid-1980s number," Mr. Gerdano said.

But why is debated.

"People are still getting protection, but the overall filing rates are staying low, which could mean the people who are filing are legitimate candidates for bankruptcy, and the people in the past who were abusing the system may not be filing now," said Ms. Fisher of the American Bankers Association.

But there's also no doubt that filings soared just before the law took effect. In just two weeks before Oct. 17, 2005, more than 600,000 bankruptcy cases were filed – as many as Mr. Gerdano projects for this year.

"Those people were filing the last gasp to take advantage of Chapter 7," Mr. Gerdano said.

Before the law took effect, the ratio of Chapter 7 to Chapter 13 filings also soared. In October, November and December of last year, 86 percent of personal bankruptcies nationwide were Chapter 7 filings, compared with 71 percent in the same three-month period in 2004.

Since the law, in the three months ending in June, Chapter 7 filings have dwindled to 61 percent of filings.

That's what supporters of the law wanted. But critics say it's not due so much to the provisions of the law than to the buildup to it.

"People now think that bankruptcy is no longer available to them because there was so much media hype," Mrs. Chesnutt said.

Mr. Gerdano said a study of the financial assets of those filing for bankruptcy shows that, this year, more filers have higher incomes and assets that make them eligible for Chapter 13.

In other words, fewer Chapter 7-eligible consumers are filing.

"It's not because the law has shifted people through the means test," Mr. Gerdano said. "This is more because of the economic condition of the people going in. They've got assets – they didn't have to file to beat some deadline."

Driving debt

Mr. Gerdano said he expects bankruptcy filings to rise again because of the insatiable thirst of consumers to part with their money.

"Consumer debt is still high, suggesting that next year those numbers may be back up," he said. "In an economy that is so dependent and so driven by consumer debt and household spending, as night follows day, bankruptcies follow that kind of consumer activity."