American Bankruptcy Institute

2021 Consumer Practice Extravaganza

The Legislative Landscape for Consumer Bankruptcy: Chapter 10, Student Loans and Beyond

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Analysis of Pending Consumer Bankruptcy Legislation

This paper reviews and analyzes recently introduced bills in Congress bearing on consumer bankruptcy practice. In particular, focus is placed on S. 4991, the proposed Consumer Bankruptcy Reform Act of 2020, S.145, the proposed Medical Bankruptcy Fairness Act of 2021, and S 2598, the FRESH START Through Bankruptcy Act. Each of these bills have been read and referred to the Senate Judiciary Committee. No further action has been taken on them at the time of the writing of this paper. This analysis is intended to be at "high level" and not a "deep dive."

S 4991 – Consumer Bankruptcy Reform Act of 2020

This bill, introduced by Senator Warren, and co-sponsored by Senators Durbin and Whitehouse, is the most extensive and comprehensive bankruptcy bill currently under consideration. A companion bill in the House, H.R. 8902, is sponsored by Representative Jerrold Nadler. These bills were reintroduced in the last Congress and have yet to be reintroduced in the 117th Congress.

As summarized in congress.gov:

This bill generally revises consumer bankruptcy law by establishing a new

Chapter 10 for individual debtors with not more than $7.5 million in debt. The bill eliminates the ability of individual debtors to file for bankruptcy under Chapter 7 liquidation bankruptcy and repeals Chapter 13, which requires individual debtors to comply with a repayment plan to receive a discharge of debt.

Under Chapter 10, debtors may receive a discharge of debt through making minimum payment obligations based on the debtor's assets and income which may result in immediate discharge for individuals with no minimum payment obligation. The bill also provides for residential protections for debtors and revises what type of debt is dischargeable in bankruptcy. An individual may obtain a discharge under Chapter 10 once every six years.

Individuals may seek limited bankruptcy proceedings on certain debts, such as a home mortgage.

The bill also establishes consumer bankruptcy protections, including by creating a Consumer Bankruptcy Ombuds at the Consumer Financial Protection Bureau.

This elimination of chapter 7 for most individual debtors and of chapter 13 as presently constituted, would have a profound impact on the bankruptcy system. Section 101 of the proposed CBRA should be reviewed to consider both the “Findings” and “Purpose” of the bill. These findings are an indictment of the existing bankruptcy system and reflect a serious purpose to change bankruptcy from a creditor-oriented system to a debtor-oriented system. The role of the bankruptcy trustee would be fundamentally altered.

Creation of a Single Chapter 10 for Debtor Relief

A new kind of Trustee

Chapter 7 trustees for most individuals and chapter 13 trustees as presently known would cease to exist. Section 1001 of the CBRA would call for either a panel trustee or a standing trustee to be appointed.[1] It seems far more likely that the Chapter 10 trustee would be a standing trustee rather than a panel trustee. The chapter 10 trustee will have all the responsibilities of an existing chapter 7 trustee under Section 704 of the Bankruptcy Code.[2] While the trustee will be able to be heard on valuation of property subject to a lien[3] or address the court relative to a repayment plan, residence plan or a property plan,[4] the trustee's role otherwise seems to be supervisory and relatively passive. The trustee would enforce any unpaid amounts on a repayment plan (see below).

The trustee would not be allowed to advocate for anyone, advise anyone on legal matters or raise an objection to a plan on the basis of its treatment of a secured claim.[5] The trustee would have enhanced duties relative to domestic support obligations.[6]

Enhanced Debtor's Rights and Privileges

While the trustee's duties under CBRA would appear to be highly circumscribed, the rights of debtors would be significantly enhanced. All powers previously reserved to the trustee under sections 363 and 364 would now be exclusively vested with debtors. Further, debtors could exercise avoidance powers if not exercised by the trustee.[7] A debtor engaged in business remains in control of

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[1] The following references are to the Bankruptcy Code as CBRA proposes to amend it
[2] § 1001(b)(1)
[3] §1001(b)(2)(A)
[4] §1001(b)(2)(B)
[5] §1001(c)
[6] §1001(d)
[7] §1002

and would be able to continue to operate that business.[8] The debtor would generally remain in possession of property of the estate.[9] In addition to being able to object to a plan, it seems that the strongest right a creditor might have is to seek dismissal in the event that the debtor is somehow acting in a manifestly unfair manner.[10] Debtors would have enhanced opportunities to obtain credit.[11] The CBRA provides for an enhanced co-debtor stay.[12] Finally, the CBRA requires that anything in the act be interpreted in the manner most favorable to the debtor.[13]

Three Types of Plans – Tender – Alternative to Tender.

The CBRA provides for the possibility of a "Repayment Plan", a "Residence Plan" and a "Property Plan."[14]

The "Repayment Plan" is essentially a 36-month chapter 13-type plan. CBRA first calculates a minimum payment obligation (MPO) for debtors with nonexempt assets or income above a certain threshold. Debtors with no MPO earn a discharge without further action. Debtors with an MPO must file a 36-month repayment plan to retire the MPO. However, the payments could be irregular or in different amounts depending on the debtor's income stream. There would be much more flexibility in terms of duration of the plan. Debtors with an MPO earn a discharge at confirmation of the repayment plan. If the debtor fails to pay the MPO, the trustee can enforce the MPO.

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[8] §1103
[9] §1004
[10] §1005
[11] §1008
[12] §1009
[13] §1010
[14] §1021

The only instance in which property could actually be liquidated for creditors is in the event that the trustee successfully "requests tender" of property.[15] But the trustee could only do so if such tender would result in a "meaningful distribution to creditors." And even then, the debtor could elect to make equivalent payments in installments to the trustee.[16]

The "Residence Plan" would allow for a variety of options not presently available, including cramming down a residential mortgage to the amount of the "allowed secured claim" and a provision to deal with zombie mortgages through a forced vesting of the property with the lender.; [17]

The "Property Plan" would allow for similar options as the residence plan. The 910-day rule with respect to cramming down liens on personal property would be eliminated and be retained only PMSIs in new automobiles bought within 120 days of bankruptcy.[18]

The CBRA addresses the manner in which a plan is to be confirmed. Since this aspect is more procedural, the reader should refer to the bill for details.[19]

Duties of the Trustee

The chapter 10 trustee would be a hybrid of the current chapter 7 and chapter 13 trustees and have a set of duties not imposed upon either of these types

[15] §1022(a)(2)(A)
[16] §1022(a)(2)(B)
[17] §1022(b)
[18] §1022(c)
[19] §§1023, 1024

of trustees under the current regime. The trustee's duties under a repayment plan would be to:

"(1) collect and be accountable for any future income of the debtor that is designated for a payment to a creditor under a repayment plan;

"(2) accept and be accountable for any property of the estate tendered by the debtor pursuant to a repayment plan under section 1022(a)(1)(A)(i)(II); and

"(3) reduce to money and be accountable for any property of the estate tendered by the debtor under the repayment plan as expeditiously as is compatible with the best interests of the parties in interest.[20]

Once the debtor starts making payments, the trustee would have a further set of duties:

(b) PAYMENTS.—

"(1) IN GENERAL.—Except as provided by section 1027 and unless the court orders otherwise, not later than 30 days after the date of the order for relief under this chapter, the debtor shall—

"(A) commence making payments in the amount proposed to be made under a repayment plan; and

"(B) tender to the trustee any relevant property of the estate requested by the trustee under section 1022(a)(1)(A)(i)(II) unless the debtor has elected under section 1022(a)(2)(B) to pay the trustee for the value of such property under a repayment plan.

"(2) ACTION BY TRUSTEE.—

"(A) RETENTION OF PAYMENTS PENDING PLAN CONFIRMATION.—The trustee shall retain a payment made under paragraph (1) until the date on which the repayment plan is confirmed or denied under section 1024.

[20] §1025(a)

"(B) DISTRIBUTION OF PAYMENTS.—If a repayment plan is confirmed under section 1024, the trustee shall distribute any payments retained under subparagraph (A) in accordance with the repayment plan as soon as is practicable.

"(C) RETURN OF PAYMENTS.—The trustee, after deducting the sum of each allowed administrative expense under section 503(b), shall return to the debtor any payments retained under paragraph (1) if the case is dismissed or converted.[21]

Enforcement of A Plan

The trustee would have the right to enforce a plan, but a plan is considered to be no more than a contract under applicable state law. Moreover, a trustee would not be able to enforce a plan unless there had been a 90-day delinquency.[22] Trustee compensation is rather circumscribed. The CBRA seems to tilt in favor of the appointment of standing salaried trustees similar to those serving as chapter 13 trustee today.

Highlights of Residence Plans or Property Plans

Consistent with the debtor-friendly provisions of the CBRA, the debtor's certification that they have cured a default would be presumptive evidence that the default had been cured.[23] Confirmation of a plan precludes any enforcement by any secured creditor unless there is a 120-day default in the case of a residence plan or a 90-day default in the case of a property plan.[24] At confirmation, all property vests in the debtor free and clear of liens other than those provided for in the plan.

While we are at it

Ipso facto clauses would be void. Arbitration agreements would be void.

[21] §1025(b)
[22] §1025(e)
[23] §1026(b)(2)
[24] §1028(c)

Joint-action waivers also would be void.[25]

The Limited Proceeding

Just in case a debtor finds the new regime too onerous, they could elect to have a "limited proceeding" to deal with as few as one debt. So, the concept that "I am not filing bankruptcy on my car" would be given life after having been a non-sequitur for the entire history of the bankruptcy process.[26]

"Other Amendments"

Chapter 7 would be gone for most individuals. Chapter 13 would be gone.[27] The Bureau of Consumer Financial Protection would have the right to appoint an "ombuds"[28] within the Bureau to aid in the informal resolution of complaints between consumers and creditors, much as the Bureau does now with other consumer credit issues The nature of the relationship between the debtor and their attorney is entirely re-written, and CBRA creates a procedure to allow debtors to pay their attorneys over time and to do so postpetition.[30] Claims procedures are rewritten so that if there is a successful objection to a claim, costs and attorney's fees could be imposed against the creditor, including claims filed beyond the statute of limitations. Punitive damages against such a creditor, up to 50% could be allocated to the debtor or the trustee to the exclusion of other creditors.[31]

[25] §1028(k)
[26] §1051 et seq.
[27] CBRA §103
[28] Presumably this is a Scandinavian gender-neutral term.
[30] CBRA §309(n) totally amends Section 329 of the Bankruptcy Code.
[31] CBRA §104(aa) et seq

Real estate would be exempt for senior people in an amount equal to 75% of the “conforming loan amount” and for others in an amount equal to 50% of the “conforming loan amount” and the time of the case. Other exemptions would also be dramatically increased including 100% of damages in connection with personal injury claims involving bodily damages, injury, pain, or suffering. Even the federal wild card” would be increased to $30,000. But if a debtor has more than $1.5 million in assets, that would be considered “manifestly unnecessary.”[32] Exemptions would increase based on the number of dependents the debtor had.[33]

In-person meetings would not be required for the most part if the debtor would have to travel more than 10 miles to get there.

Brief Commentary

The proposed CBRA would disrupt the entire debtor-creditor regime as is currently understood by bankruptcy practitioners. The roles of the chapter 7 trustee and the standing chapter 13 trustee would be completely altered.

While the author represents debtors and serves as a chapter 7 trustee, the author does not express his personal views as to the merits of the proposed changes. The author is of the view that the proposed changes appear to be aspirational rather than having any real chance of enactment as a package or even as a concept. The significant change of the balance between debtor’s remedies and creditors rights in the proposed CBRA might also have unforeseen consequences relating to

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[32] CBRA §104(ff)
[33] *Id.*

the extension of credit generally. One might expect significant objections to these proposals from many vested interests that have many strong voices in Congress.

The Medical Bankruptcy Fairness Act of 2021

This proposal, sponsored by Senator Whitehouse and co-sponsored by Senators Brown, Blumenthal, Baldwin, and Warren, is substantially more focused and less comprehensive than the CBRA. This bill defines a "medically distressed debtor" and affords such a debtor enhanced protections and rights:

> This bill allows medically distressed debtors to exempt certain property from their estates in bankruptcy, which allows them to retain ownership of such property. Specifically, a medically distressed debtor may exempt up to $250,000 of the debtor's interest in (1) specified real or personal property that the debtor or debtor's dependent uses as a residence, or (2) a burial plot for the debtor or debtor's dependent.
>
> The bill also waives certain administrative and procedural requirements for a medically distressed debtor.
>
> Additionally, the bill allows a medically distressed debtor to discharge in bankruptcy debts for certain education loans.
>
> A debtor who seeks relief as a medically distressed debtor must attest in writing that the debtor's medical expenses are genuine and were not incurred to bring the debtor within the meaning of a medically distressed debtor under this bill.

The MBFA adds a new definition to the Bankruptcy Code, that of a "medically distressed debtor"[34] Such a person would be entitled to a homestead exemption of up to $250,000. Such a person would also be able to establish discharge student loans under Section 523(a)(8) of the Bankruptcy Code. Such a

[34] That definition can be found in Section 2 of the proposed MBFA.

person would even be relieved of the responsibility to get credit counseling prior to filing.

This bill has been referred to the Judiciary Committee and has been read. No further action has been taken on it as of this writing.

The FRESH START Through Bankruptcy Act

This bill, introduced by Senator Durbin, co-sponsored by two Republican Senators, Senators Cornyn and Hawley, is the only bi-partisan bill that has been introduced. No official summary of this bill has been published as of this writing.

FRESH is an acronym for "Fostering Responsible Education Starts with Helping Students Through Accountability, Relief, and Taxpayer Protection." In general, this bill would allow student loans to be discharged in bankruptcy after 10 years. The bill also provides for various obligations to the education institutions that most bankruptcy lawyers won't find interesting.

Other pending legislation

Attention is called to other pending legislation that might affect student loans:

<u>S. 2596</u> – *Leveraging Opportunities for Americans Now (LOAN) Act* [Sen. Marco Rubio (R-FL)]: <u>would</u> eliminate interest on federal student loans and replace it with a one-time, non-compounding financing fee that borrowers would pay over the life of the loan.

H.R. 4797 **[Rep. Troy Carter (D-LA-2)]**: would direct the Secretary of Education to discharge up to $50,000 of Federal student loan debt for each borrower.

H.R. 4727 – ***Student Loan Interest Deduction Act*** **[Rep. Eric Swalwell (D-CA-15)]**: would double tax deductions for student loan interest (from $2,500 to $5,000) and eliminate income phase-outs.

H.R. 4725 – ***No Student Loan Interest Act*** **[Rep. Eric Swalwell (D-CA-15)]**: would eliminate and forgive all interest charges on existing federal student loans and eliminate all interest charges on future federal student loans by enacting a zero percent interest rate.

H.R. 4724 – ***Strengthening Loan Forgiveness for Public Servants Act*** **[Rep. Eric Swalwell (D-CA-15)]**: would allow borrowers to receive forgiveness under the Public Service Loan Forgiveness program in proportion to their years of public service.

Consumer Bankruptcy Reform Act Summary

The *Consumer Bankruptcy Reform Act* will modernize the consumer bankruptcy system to make it easier for individuals and families forced into bankruptcy to get back on their feet.

I. Makes it easier and less expensive for financially-strapped families and individuals to get financial relief.

- Replaces chapter 7 and chapter 13 with chapter 10, a new consumer bankruptcy chapter, and provides two routes for individuals to file for bankruptcy:
  - **Route 1: No-payment discharge.** For low-income/low-asset filers with no minimum payment obligation, this option wipes out all unsecured debt except for certain categories of debt, such as child support or debts incurred by fraud. A minimum payment obligation arises for debtors with valuable assets available to pay creditors or with an annual income over 135% of the median income for the state and household size. Discharge has no impact on liens on property.
  - **Route 2: Debt-specific plans.** Creates bankruptcy plans that allow individuals to resolve the debts that are specific to them. Individuals can file one or more plans, and collection of debts are paused while the filer remains current on a plan.
    - **Repayment plan (for unsecured debt, like medical, credit card, and student loan debt)**: Provides for payment of the filer's minimum payment obligation. Plans are repaid over the course of 3 years through a trustee, with the repayment obligation secured by a lien on the debtor's nonexempt property. Individuals with a minimum payment obligation must file a repayment plan to receive a discharge.
    - **Residence plan (for home mortgages)**: Addresses mortgages on the individual's principal residence. Repaid directly by the debtor.
    - **Property plan (for secured debt other than home mortgages, like car loans)**: Addresses property secured by a lien other than the individual's principal residence. Repaid directly by the debtor.
- Waives filing and administrative fees if household income is at or below 150% of the poverty line.
- Ends the pre-credit counseling requirement and allows filers to pay attorney's fees through a repayment plan.

II. Ensures that filers can care for themselves and their families during the bankruptcy process.

- **For renters**: Allows renters to continue in the lease of their principal place of residence without curing monetary defaults of less than six times their monthly rent.
- **For homeowners**:
  - Eliminates the ability of states to opt-out of federal exemptions and creates a new federal floor keyed to 50% of the Federal Housing Finance Agency (FHFA) conforming loan limit for the debtor's county of residence or a similar leasehold (or 75% of the conforming loan limit for debtors aged 65 or older). Creates an additional set of federal exemptions, including a generous $35,000 wildcard exemption, which further protect debtors' key assets.
  - Allows filers with mortgages to sell encumbered property free and clear of any liens if the first lienholder refuses to take tender of the property, subject to junior liens.

    - Allows filers to modify their mortgages based on the market value of the property, with interest rates reduced to achieve a sustainable debt-to-income ratio.
- **For car owners**: Ends the requirement that filers pay the full amount of the loan in order to keep their vehicle. Under the bill, individuals are required to pay only the liquidation value of secured claims like car loans (with an exception of cars purchased 90 days before bankruptcy).
- **For individuals with student loan debt**: Removes the provision that makes private and federal student loans nondischargeable, allowing these loans to be treated like most forms of consumer debt.

III. Helps address racial and gender disparities in the bankruptcy system.

- **Racial disparities**:
    - Makes certain criminal justice fines and fees dischargeable while preventing the discharge of debts stemming from civil rights violations.
    - Requires the collection of data on race, gender, and age when individuals file for bankruptcy.
- **Gender disparities**:
    - Moves to an income- and asset-only based (as opposed to expense-based) calculation of repayment ability and replaces many line-item exemptions with one lump-sum personal property exemption adjusted by the number of dependents, rather than number of bankruptcy filers.
    - Protects certain sources of income and assets traceable to them in bankruptcy, including alimony, child support income, the child tax credit, and the Earned Income Tax Credit (EITC).

IV. Closes loopholes that allow the wealthy to exploit the bankruptcy system and prevents corporate misconduct.

- **Eliminates loopholes that benefit wealthy filers**: Permanently closes the Millionaire's Loophole by eliminating the intent requirement to show that a self-settled trust in which the settlor is a beneficiary is a fraudulent transfer, and closes the loophole for spendthrift trusts, with carve outs for bona fide disability trusts.
- **Cracks down on predatory practices and holds corporate wrongdoers accountable**:
    - Disallows all claims if the claimholder or its assignor has violated a federal consumer financial law in regard to the debtor.
    - Expands the *Fair Debt Collection Practices Act* (FDCPA) to make it an unfair practice for a debt collector to sue or file a bankruptcy claim without an actual, reasonable, good faith belief that the debt is within the applicable statutory limitations period.
    - Makes a knowing collection or attempt to collect on a debt discharged in bankruptcy an unfair practice under the FDCPA, unless the debtor has voluntarily chosen to repay the debt without pressure from the collector; allows lawsuits against creditors and collectors who collect debts discharged in bankruptcy, including in class action lawsuits; and prevents creditors from pursuing these consumers in mandatory arbitration in matters related to the bankruptcy case.
    - Establishes a new Consumer Bankruptcy Ombuds at the Consumer Financial Protection Bureau (CFPB) to handle consumer bankruptcy complaints; expands the CFPB's supervisory authority to all lenders that make loans at over a 36% military APR rate, irrespective of size; and gives the CFPB supervision and enforcement authority for title 11 consumer cases by making title 11 an "enumerated consumer law."

CREDIT SLIPS

A Discussion on Credit, Finance, and Bankruptcy

The Consumer Bankruptcy Reform Act of 2020

POSTED BY ADAM LEVITIN

Today Senators Elizabeth Warren (D-MA), Dick Durbin (D-IL), and Sheldon Whitehouse (D-RI) and Representatives Jerrold Nadler (D-NY) and David Cicilline (D-RI) introduced the Consumer Bankruptcy Reform Act of 2020. This is the first major consumer bankruptcy reform legislation to be introduced since the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). Whereas BAPCPA introduced a number of major, but targeted reforms to consumer bankruptcy law (and also a few business bankruptcy provisions as well), the CBRA is a much more ambitious bill: it proposes a wholesale reform of the structure of consumer bankruptcy law with an eye toward reduces the costs and frictions that prevent consumers from being able to address their debts in bankruptcy.

This is a long post with an extended overview of the bill. The bill's sponsors have a one-page version or a two-page summary, but I figure you're here at the Slips because you just can't get enough bankruptcy law, and we're happy to oblige. Let me start with a disclosure, though. I was privileged to provide assistance with the bill, along with several other Slipsters. That means I know what's in it, and I think it's a really good and important piece of legislation that I hope will become law.

A New Chapter 10 for Consumer Bankruptcy (Eliminating Consumer 7s and Chapter 13)

Whereas consumer bankruptcy has long existed in two primary flavors—liquidations (chapter 7) and repayment plans (chapter 13)—the CBRA proposes a single chapter structure (a new chapter 10). Under the CBRA, individual debtors would no longer be eligible for chapter 7, and chapter 13 would be repealed in its entirety. All individual debtors with debts of less than $7.5 million would be eligible for chapter 10; those with larger debts would have to file for 11 (or 12 if they qualify). It's important to keep this structure in mind when evaluating the CBRA. While the CBRA takes elements from chapters 7 and 13, the CBRA is not trying to replicate existing 7 or 13. That means if you come to CBRA with a mindset of "wait, that's not how we do it in 13," well, yeah, that's kind of the point.

The CBRA is a huge bill (188-pages) with a lot of provisions. In addition to the new chapter 10, it also contains amendments to numerous provisions in chapters 1, 3, and 5 of the Bankruptcy Code, as well to certain federal consumer financial protection statutes. I'm not going to try to cover everything in detail, but I want to cover how chapter 10 would work, as well as some of the highlights from other provisions. This is a very long post, but I think it's important for there to be a clear statement of how chapter 10 would work because there will undoubtedly be some misinterpretations of the bill, and I'd like to see consideration of the bill be on its actual merits.

Chapter 10

Chapter 10 is meant to be the single point of entry for almost all consumers. That's a contrast with the current system where consumers can "pick" between 7 and 13. I put "pick" in quotation marks because there often isn't a meaningful choice. Chapter 7 has no provision for payment of attorneys' fees, so consumers who are unable to save up for bankruptcy don't have any real option other than chapter 13. Moreover, even when a consumer is able to afford a 7, bankruptcy attorneys play a large role in deciding what chapter to file under. Part of this is that 7 and 13 have different tools, but part is also local legal culture. There are massive variations in chapter 7 vs. 13 filing rates by state—some states have a 7 culture and some have a 13 culture. That's hardly consistent with the spirit of constitutional authorization of "uniform laws on the subject of bankruptcies." What's worse, there is substantial empirical evidence that minority debtors are more likely to end up chapter 13, which is both more expensive (about 2.5x more expensive) and less likely to result in a discharge of debts (only around a third of chapter 13 cases result in a discharge, while virtually all chapter 7 cases do). Replacing the two-track system with a single chapter eliminates these disparities.

Filing for chapter 10 involves nothing more than filing a short form petition with the bankruptcy court. All of the BAPCPA credit counseling requirements are repealed. There was zero evidence that the credit counseling helped consumers—it was just an added cost and friction to getting bankruptcy relief. (But you'd better bet that this will be an industry that opposes the legislation—their government mandated business flow is threatened.)

Once a debtor files the automatic stay kicks in, as does a co-debtor stay. The debtor retains control of his or her property except as required to be surrendered to the trustee pursuant to a minimum payment obligation (discussed below). The debtor will have to file much (but not all) of the information currently required under section 521 about the consumer's assets and liabilities, and creditors will still get a chance to question the debtor at a section 341 meeting. The CBRA allows for remote attendance at a 341 meeting and does not require in-person appearance of the debtor if it would be burdensome on the debtor (including more than minimal travel). The meeting is also to be scheduled at a time that does not conflict with the debtor's employment (no reason for the debtor to miss work to go bankrupt!).

As with current law, the CBRA exempts certain property of the debtor from creditors' claims. The exemptions are updated and simplified under the CBRA. The debtor can choose between a set of federal exemptions and the debtor's state law exemptions (subject to anti-abuse cap on recently acquired homestead values). States cannot opt out of the federal exemptions, however. Key changes to the federal exemptions include a $35,000 wildcard exemption and a homestead exemption (with extra protection for seniors) keyed to the FHFA Conforming Loan Limit, which reflects geographic variations in home prices. Debtors' exemptions are also adjusted based on their number of dependents.

The key feature of the CBRA is that it screens "can't pay" from "can pay" debtors based on a combination of the debtor's nonexempt assets and future income. This is a different approach to the two-track system that lets debtors choose between giving up assets, but keeping future income (chapter 7) or keeping assets, but giving up future income (chapter 13). The CBRA's payment screen looks only to income and assets, not to expenses. What a debtor chooses to spend her money on is her business. A debtor will not have to justify choices about their children's education or medical care.

Instead, every chapter 10 debtor has a "minimum payment obligation," which is the sum of the debtor's non-exempt assets and a progressively graduated percent of annual income exceeding 135% of the state median income for a household of like size. This minimum payment obligation is what the debtor will have to pay in order to get a discharge. (For involuntary bankruptcy petitions, which are exceedingly rare currently, the minimum payment obligation is calculated only in reference to the consumer's current nonexempt assets, not the consumer's future income--no forced repayment plans.)

Immediate discharge for debtors with no minimum payment obligation

If a debtor's minimum payment obligation is zero, the debtor is eligible for an immediate discharge of all unsecured debts, other than those that are non-dischargeable under section 523. This means that the "can't pay" debtors are moved through bankruptcy incredibly quickly and at a very low cost. This is what a well-designed consumer bankruptcy system should be doing: triage among debtors and require repayment only from those who have meaningful ability to repay.

Discharge upon confirmation for debtors with a minimum payment obligation

If a debtor has a positive minimum payment obligation (the "can pay" debtors), the debtor must propose a "repayment plan," addressing the debtor's personal liability on unsecured and secured obligations, under which the debtor must pay at least that minimum payment amount over three years. That plan can be paid under any combination of future income, nonexempt assets, and exempt assets (enabling an installment redemption of nonexempt assets). Distributions under the plan follow the 726/1326 waterfall, but there is no requirement that priority claims be paid in full, only a requirement of paying the minimum payment obligation, and there is a safety valve for inability to make the minimum payment obligation when the debtor is "justly excused" for "circumstances that debtor cannot reasonably avoid". That allows some flexibility for debtors who have unusual situations, like extremely high medical expenses for themselves or a dependent. Conversely, creditors are protected by the ability to have the case dismissed for a "manifestly improper use of the bankruptcy system"—language indicating an intention to jettison the existing "substantial abuse" jurisprudence").

If the plan pays the minimum payment obligation, is feasible, is not proposed in "bad faith," covers court fees, and the debtor is current on post-bankruptcy domestic support obligations, the court is required to confirm the plan. If no objection is raised, no hearing is required for confirmation. Upon confirmation, the debtor receives an immediate discharge. This is a major change from chapter 13, where a discharge is granted only upon completion of a chapter 13 plan, something that many chapter 13 debtors fail to achieve. An individual can get a discharge under chapter 10 (whether through a repayment plan or with no monthly payment obligation) only once every six years.

The debtor's obligations under a repayment plan are enforceable solely by the bankruptcy trustee, and the obligations are secured by a lien on all of the debtor's nonexempt assets. A default on a plan does not unwind the discharge, however, and a plan may be modified based on a material change in the debtor's financial condition that would result in the plan obligations imposing a "substantial burden" on the debtor—another safety valve.

Secured debt is handled under separate "residence" and "property" plans

Under chapter 10, secured debt is handled under separate "residence" or "property" plans for the debtor's principal residence and all other property. A residence or property plan allows the debtor to change the terms of secured obligations, but does not result in a discharge. A discharge is possible only with coupling the plan with a repayment plan or having no minimum payment obligation. This means that in chapter 10, a consumer can adjust the interest rate and amortization schedule of a loan or cure a default on the loan. Chapter 10 also removes chapter 13's restrictions on mortgage modification ("cram down"), and pars back (but does not eliminate) the restriction on auto loan lien stripping. Chapter 10 also enables consumers to get rid of "zombie" mortgages through a right of first refusal process.

Residence and property plans operate substantially similarly other than the plan period and the relevant interest rate prescribed. The secured creditor keeps its lien and debtor must pay the secured creditor the value of the lien as of the effective date of the plan based on an interest rate prescribed for mortgages and cars (meaning *Till v. SCS Credit Corp*. would apply only to other, unusual collateral). The rates are calculated in reference to an average prime offer rate. Payments can be made over the longer of 15 years or 5 years after the stated maturity date for a residence. For cars and other property, the plan can be over the longer of 5 years or the the stated maturity date of the debt. Payments under a residence or property plan are handled directly by the debtor, but the secured creditor is stayed from taking any action unless there is a default under the plan, which requires 120 days delinquency for mortgages and 90 days delinquency for everything else.

Limited Proceedings—decoupling debtor's financial obligations

One of the major innovations of chapter 10 is that it decouples a debtor's various financial obligations. Currently a consumer who files for bankruptcy faces a day of reckoning with all creditors—the credit card issuer, the tort creditor, the mortgage lender, the car lender, the student lender, the tax authority, etc. It does not matter if the consumer is only have a problem on the mortgage or with the credit card debt. All of the debts get pulled into the bankruptcy. There is no way to deal with debts a la carte under current law. Chapter 10 changes that by introducing the concept of a "limited proceeding." A debtor may elect at the time of filing to conduct a "limited proceeding," that consists of solely a residence or property plan—treating only secured debt--which means no discharge. This is particularly useful as it enables a cure of a mortgage or car loan without a full-blown bankruptcy.

Other CBRA provisions

There are a number of other CBRA provisions of note. First, eliminating consumer chapter 7 means that the BAPCPA "means test" is gone. So too is single-shot redemption of nonexempt property (installment redemption is allowed). Reaffirmations are also entirely gone.

Second, the CBRA creates a provision for the payment of attorneys fees in chapter 10. That's key because it means that debtors can pay their attorneys over time if they don't have the money today (and they are bankrupt after all).

Third, the CBRA makes it possible for renters to keep their residences. Under current law, a renter must pay all back rent in order to keep a rental residence. That's generally impossible if there's more than a month or two of back rent owing--othewise the debtor wouldn't be filing for bankruptcy. The CBRA allows renters to stay in their leases without having to pay several months of back rent. That back rent is treated like any other unsecured debt. There's no reason landlords should be special in this regard.

Fourth, the CBRA create a role for the Consumer Financial Protection Bureau in consumer bankruptcy. The CFPB is authorized to appear and be heard in any bankruptcy case and will have the authority to enforce its prohibition on unfair, deceptive, and abuse acts and practices in chapter 10 cases. Moreover, the CBRA creates a "Consumer Bankruptcy Ombuds" at the CFPB, a parallel to the existing Student Loan Ombudsman position. This means that there will be a permanent office in the CFPB responsible for consumer bankruptcy. The Consumer Bankruptcy Ombuds is tasked with a range of duties: data analysis, policy recommendations, but also setting up an informal dispute resolution system.

Fifth, the scope of what is or is not dischargeable is also amended. Section 523 is amended to make certain previously non-dischargeable debts (most notably student loans and certain types of criminal justice-related debts, like costs of public defense or incarceration) fully dischargeable. At the same time, certain types of debt, like those incurred in civil rights violations, are made nondischargeable. The discharge has much sharper teeth under the CBRA—discharge violations are now a free-standing cause of action.

Sixth, the CBRA expands claim disallowance to include "bad boy" grounds—violations of federal consumer financial laws. The bankruptcy system is a federally operated debt collection system, and creditors who want succor in the system must have clean hands.

Seventh, the CBRA updates the damages provisions of federal consumer financial laws. Some of these statutes have not had their damages provisions--which are not inflation adjusted--amended since the 1970s. They have become toothless. CBRA gives them a set of choppers that reflect their original bite and ensures that they will be inflation adjusted going forward.

Eighth, the CBRA truly closes the Millionaire's Loophole for self-settled trusts.

Ninth, the CBRA fixes a plethora of bad Supreme Court decisions (actually, it's hard to think of a consumer bankruptcy case where SCOTUS got it right!). These are things that only a bankruptcy lawyer cares about, but it's nice to see decades of damage undone.

Finally, the CBRA creates a robust bankruptcy data collection system. Good policy needs data.

Politics

I do not want to get into a discussion here of the politics of the bill, beyond noting three things. First, the foundation for the CBRA is the consumer bankruptcy plan from Warren's Presidential campaign, which President-Elect Biden has adopted as his own. Second, the bill has already been endorsed by an impressive array of consumer, civil rights, and labor organizations, and has among its original co-sponsored the the House Judiciary Committee Chair, House Judiciary Antitrust, Commercial, and Administrative Law Subcommittee Chair, and the possible Senate Judiciary Committee Chair. That means the bill has the possibility of moving in committee. And third, there will also be a real need for ensuring access to effective bankruptcy relief, as we will be facing a tidal wave of COVID-19 related consumer financial distress in 2021, when moratoria on foreclosures, evictions, and collections lapse. The CBRA offers a legislative path to improving access to justice for hard pressed consumers and ensuring that the bankruptcy system offers them all of the tools necessary for addressing financial distress.

Posted on December 9, 2020

https://www.creditslips.org/creditslips/2020/12/the-consumer-bankruptcy-reform-act-of-2020.html

CREDIT SLIPS

A Discussion on Credit, Finance, and Bankruptcy

Thoughts on Student Loans and the FRESH Start Act

POSTED BY BOB LAWLESS

A new bill from Senators Durbin and Cornyn promises a way out of student loan debt through a change in the bankruptcy laws. The Fresh START Through Bankruptcy Act of 2021 makes one principal change. After 10 years from the date they first came due, federal student loans would be freely dischargeable. Before 10 years, student loans would be dischargeable only if the debtor could show undue hardship, which is the standard currently. Private student loans would remain nondischargeable at all times except upon a showing of undue hardship. This is not the bill I would write, but it's a step in the right direction.

How could the bill be improved? First, ten years is too long. It is the entire regular repayment period for a federal student loan. Do we really think that debtors should have to struggle for ten years before becoming eligible for a student-loan discharge. For example, from our "Life in the Sweatbox" paper, 60% of the people who reported they struggled for at least *two* years before bankruptcy said they went without medical attention and 47% said they went without a prescription they needed.

My personal preference would be to make federal students loans freely dischargeable 3 to 5 years from their original due date. Immediate discharge raises potential for abuse that the bankruptcy system would not be able to completely police. The American Bankruptcy Institute's Commission on Consumer Bankruptcy had similar concerns and recommended a 7-year waiting period. This bill with a 10-year waiting period is obviously a compromise for Senator Durbin, who has previously supported complete dischargeability for student loans as well as outright cancellation of some student loans outside of bankruptcy. Senator Durbin's political judgment is better than mine. A shorter waiting period is better than the one currently in the bill, but at least having any time window after which student loans become nondischargeable is much better than what we have now. Notably, the National Association of Consumer Bankruptcy Attorneys supports the legislation.

The new bill does nothing to address private student loans. Some protection for government loans makes sense because the government has to lend and at the same rate regardless of the creditworthiness of the student borrower. If the bill does become law, however, we will have the perverse situation where private lenders who can make their own underwriting decisions about to whom to lend and at what rate will have more protection than the federal student loans. In this compromise, someone is carrying the water for the financial industry, and I am guessing it is not the senator who previously had argued for very broad discharges of student loans.

The bill also has a clawback provision aimed at colleges and universities whose graduates discharge their student loans in bankruptcy. If at least one-third of a school's student body receives federal loans, the school would have to reimburse the Department of Education for a percentage of the discharged loan if the school's graduates fell above fairly generous thresholds for default and below repayment thresholds. The amount would range between 20% and 50%, depending on how far above or below the thresholds the school fell.

Colleges and universities should have "skin in the game," but this clawback provision is not ready for prime time, to say the least. First, it has no mechanism to initiate the clawback. For example, does the trustee or the court notify the Department of Education about the dischargeabilty finding on a student loan? Second, there are serious due process issues if a court judgment triggers a payment obligation to a school. The school would seem to need to get notice and a right to be heard. If so, the law would put the school in an adversarial position to its former student. Third, because a school would have an interest now in not having the loan nondischargeable, does that give the school the incentive to offer the former student some money to "settle" the nondischargeability complaint and make it go away. Fourth, do bankruptcy courts even have the constitutional power to issue an order with the consequence that a nondebtor would have to pay a third party? Yes, under the proposed legislation the bankruptcy court finding of dischargeability is not formally a "judgment" against the school, but it walks and talks like one. Given the problems with it, the clawback provision would have to be substantially changed if the bill were ever to become law. A more direct approach would be to delink clawback from bankruptcy and instead amend the Higher Education Act of 1965, perhaps creating an obligation on any college or university who receives federal student loans to make a payment to the Department of Education if graduate default rates fell above some threshold.

The Fresh START Act is far from perfect, but if the political judgment is that it is the best path to do anything about student loans given the political realities of today, it is worth exploring.

Posted on August 4, 2021

https://www.creditslips.org/creditslips/2021/08/thoughts-on-student-loans-and-the-fresh-start-act.html

December 14, 2020

The Honorable Elizabeth Warren
United States Senate
317 Hart Senate Office Building
Washington DC 20510

Dear Senator Warren:

We are 74 law professors who specialize in bankruptcy and consumer law. We write to express our support for the Consumer Bankruptcy Reform Act of 2020, S.4991. The consumer bankruptcy system is expensive and complex, and it too often fails to provide effective relief. People who need to file bankruptcy can be shut out altogether when they cannot afford to hire an attorney to help them navigate the bankruptcy process. We support the Consumer Bankruptcy Reform Act because it will address these systemic issues as well as many other problems that plague the current consumer bankruptcy system.

Congress enacted our current Bankruptcy Code in 1978. Much has changed since then. Even after adjusting for population growth and inflation, Federal Reserve data show that credit-card debt has tripled. In 1978, student-loan debt was such a small part of household finances that the Federal Reserve did not even separately track it. Today, student-loan debt is the largest component of household debt except for home mortgages. In 1978, asset securitization was in its infancy. Mortgages and auto loans are now routinely bundled and sold to investors, separating the servicing of the loan from the financial institutions that own the loan. Advances in technology have made it easier for debt collectors to hound consumers even for debts that are decades old. In 1978, what we now think of as the Internet was a little-known research tool for academics instead of a global information revolution that has affected how Americans interact, including with consumer lenders, attorneys, and the court system. Given all these changes, it is little surprise that a forty-year-old bankruptcy law no longer serves our needs today.

The central piece of the Consumer Bankruptcy Reform Act is to create a new chapter 10 for individual bankruptcy filers. The Act also eliminates chapter 7 as an option for individual filers and repeals chapter 13. Individuals will remain able to file under chapter 11 (those with debts over $7.5 million will be required to use that chapter), but for most people, the new chapter 10 will be a single point of entry into the bankruptcy system.

The single point will substantially improve the consumer bankruptcy system by replacing the current structure where consumer debtors must choose between a chapter 7 liquidation bankruptcy or a chapter 13 repayment plan bankruptcy. There are substantial differences around the country in the rates at which people use chapter 7 and chapter 13. In 2019, only 9.6% of the bankruptcy cases in the District of Idaho were chapter 13 cases as compared to 81.0% of the cases in the Southern District of Georgia. The gaping disparity itself is an indictment of a federal system that the Constitution directs to be "uniform."

Academic studies and media articles have documented that Black households are more likely to end up in chapter 13. Although chapter 13 can be a good choice for people who wish to retain assets they would otherwise lose in a chapter 7, chapter 13 is far more expensive, and it takes years rather than months for a debtor to complete a chapter 13 plan and receive a bankruptcy discharge. Also, more than 50% of chapter 13 debtors do not receive a discharge because they are unable to complete their repayment plan. The racial disparity in chapter choice is deeply troubling, especially given that bankruptcy lawyers must necessarily play a role in the chapter-choice decisions.

For most chapter 10 debtors, relief will be swift. Immediately upon filing a chapter 10 petition, a consumer bankruptcy debtor will face a screen for income and assets reasonably available to pay creditors. Debtors who pass this screen will receive an immediate discharge and be sent on their way. Debtors who have income or assets to pay creditors will have a minimum payment obligation they meet over three years. Debtors will not have to wait to receive a discharge but, if they fail to pay, they will be pursued by the bankruptcy trustee for nonpayment.

A debtor's minimum payment obligation is based on a combination of the value of all nonexempt assets plus the amount by which the debtor's income exceeds 135% of their state's median income for a household of like size. Debtors can satisfy this minimum payment obligation by surrendering nonexempt, unencumbered assets to the bankruptcy trustee or by paying out of future income. These asset and income screens are a reasonable approach to catching the few "can pay" debtors while getting the many more "can't pay" debtors out of the system quickly, efficiently, and cheaply.

The current system often turns on what the debtor spends. In contrast, the new chapter 10 focuses on what the debtor has. By doing so, chapter 10 would get the bankruptcy courts out of the business of making decisions best left to the family. Debtors who want to sacrifice in some areas to meet a payment obligation so their children can attend a private religious school will not have to explain why their decision is reasonable. Debtors with what might be considered nontraditional families will not have to justify the choices they have made about whose expenses belong to the household. Chapter 10 will not be a free ride, but it will recognize the diversity of American households.

Importantly, chapter 10 eliminates unnecessary complexity and useless paperwork and ineffective credit counseling for the vast majority of bankruptcy filers. Although chapter 10 will catch "can pay" debtors, study after study has shown that most every bankruptcy filer arrives in bankruptcy court in dire financial shape, suffering not from bad choices but from bad luck. Under current bankruptcy law, attorneys must document the debtor's income from the past six months even when it is apparent the debtor's income is far below any threshold where it would be legally relevant. These requirements drive up costs to no one's benefit, and understandably lead lawyers to charge more to help with bankruptcy cases because of the increased burdens on their time. The Consumer Bankruptcy Reform Act will allow debtors to establish income with basic documentation and will allow attorneys to rely on that documentation unless it shows that the debtor was within 80% of the relevant threshold. The Consumer Bankruptcy Reform Act also eliminates other unnecessary filing requirements for debtors. In combination with its simpler procedures, chapter 10's streamlined disclosures should lower attorney's fees and provide better access to the bankruptcy system for those who need it.

The Consumer Bankruptcy Reform Act also creates a pathway for people to pay for their attorneys. Because bankruptcy wipes out a filer's obligations, bankruptcy attorneys usually will ask for payment upfront before filing a chapter 7. At present, consumers without the money to afford an attorney might use chapter 13 to pay for that attorney. If so, the cost of their bankruptcy case will now be closer to the $3,800 it costs for a typical chapter 13 rather than the $1,300 it costs for a typical chapter 7. Nevertheless, many people are forced into chapter 13 just to pay for attorney representation, only to have their chapter 13 case fail when they cannot complete the plan payments. The Consumer Bankruptcy Reform Act creates a procedure for debtors to pay their attorneys over time through the bankruptcy plan. Unlike in chapter 13, however, if the debtor is ultimately unable to pay the attorney's fees, the debtor's discharge will not be jeopardized. The Consumer Bankruptcy Reform Act ensures that bankruptcy attorneys are fairly compensated for their services—and thus will continue to provide those services—without letting the fees become an obstacle to access to justice.

The Consumer Bankruptcy Reform Act streamlines the bankruptcy process in other ways. Like current law, it gives a debtor tools to try to save a family home or motor vehicle, but it unpackages those tools into their own separate components. A consumer who is having problems with a home mortgage or an auto loan can use chapter 10 to deal only with that mortgage or auto loan, leaving the rest of the consumer's financial affairs out of the bankruptcy case. By doing so, the Consumer Bankruptcy Reform Act should incentivize a home or auto lender to reach an out-of-court solution for a loan that has fallen behind. If the home or auto lender does not want to cooperate, chapter 10 gives the debtor a tool to deal with that loan only. This streamlined process should further lower costs to consumers by eliminating the need for a full-blown bankruptcy case just to deal with one troubled loan.

The Bankruptcy Code has never given effective tools for renters to try to stay in their residences. Renters have always been required to immediately catch up on all back rent if they want to keep their residence—usually an impossible task. The Consumer Bankruptcy Reform Act remedies that gap by giving renters the ability to stay in a lease and treat several months of rent arrearage like any other debt.

Bankruptcy is also a type of debt collection procedure, and legal scholarship has documented many abusive debt collection practices spilling over into bankruptcy. Many consumer debts themselves were incurred in violation of various federal and state consumer protection laws. The Consumer Bankruptcy Reform Act tackles these abuses head on. It provides for the disallowance of claims if the underlying debt violates consumer financial protection laws, and it enables debtors to obtain compensation from creditors that harass them in violation of the bankruptcy discharge injunction. The Consumer Bankruptcy Reform Act also gives the Consumer Financial Protection Bureau a role in bankruptcy, enabling the Bureau to appear in bankruptcy cases and to create a process for informal resolution of complaints of individual debtors. Additionally, the Consumer Bankruptcy Reform Act provides much needed updating and inflation indexing of the remedial provisions of federal consumer financial protection laws, which date back to the 1970s without inflation adjustment.

As bankruptcy and consumer law scholars, we have focused this letter on the important structural changes the Consumer Bankruptcy Reform Act would make, but we would be remiss not to mention one specific change that will have great benefits for many consumers. The Act would make student loans like any other debt by making them subject to the bankruptcy discharge. Student loan debt is crushing households across America. Money that would be going into purchasing new homes and building new families is instead going to pay overwhelming student loan debt, often from a predatory educational institution that failed to deliver the education it had promised. Again, chapter 10 will not be a free ride. Debtors who can pay will not be able to walk away from their obligations. For debtors who cannot pay, allowing student-debt relief is not only the right thing to do but also helps the economy by freeing up income for productive investment to help people build their financial lives.

Although we have listed our titles and affiliations below, we speak for ourselves and not our institutions. Similarly, the signatures on this letter should be not be understood as any individual's endorsement of every word of the bill now or after it is amended. The Consumer Bankruptcy Reform Act provides a thoughtful, workable, and comprehensive response to the problems that plague the current consumer bankruptcy system, which is why we support it.

Sincerely,

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Prof. Adam J. Levitin is the Anne Fleming Research Professor and Professor of Law at Georgetown University Law Center in Washington, D.C., where he teaches courses in bankruptcy, commercial law and financial regulation. Before joining Georgetown faculty, he practiced in the Business Finance & Restructuring Department of Weil, Gotshal & Manges, LLP, and clerked for Hon. Jane R. Roth on the U.S. Court of Appeals for the Third Circuit. Prof. Levitin has also previously served as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School, as the ABI Robert N. Zinman Scholar in Residence, as special counsel to the Congressional Oversight Panel for the Troubled Asset Relief Program, and on the Consumer Financial Protection Bureau's Consumer Advisory Board. A laureate of the American Law Institute's Young Scholar's Medal, he has testified before Congress more than 30 times and is the author of numerous books and articles. Prof. Levitin is also a elected member of the American Law Institute and a Fellow of the American College of Consumer Financial Services Lawyers. He received his A.B. *magna cum laude* in Near Eastern languages and civilizations and history from Harvard College, his A.M. and M.Phil. in history from Columbia University, and his J.D. *cum laude* from Harvard Law School.