

THE WHITE HOUSE
WASHINGTON

April 13, 1999

MEMORANDUM TO THE NEC DEPUTIES

FROM: *For* BANKRUPTCY WORKING GROUP

RE: BANKRUPTCY REFORM PROPOSAL

We are working on a strategy designed to increase our leverage, reduce the likelihood that the President will be presented with a bill that he will want to veto, and try to prevent a veto override, if a veto is necessary. Specifically, we plan to: (1) exploit publicly the vulnerabilities of the legislation (by presenting sympathetic scenarios of debtors denied access to a fresh start under the bill, attacking provisions in the bill that roll back existing protections against abusive and coercive collection practices, highlighting the bill's failure to improve disclosure and stem credit card abuses, and critiquing lingering danger it presents to child support and alimony collection); (2) work with bill proponents and opponents (including Senators Torricelli and Grassley and Representative Nadler) to advance alternative provisions that would substantively improve the current bills; (3) work with Senators Durbin, Kennedy, Leahy and others to develop a Senate floor strategy and identify message amendments which could motivate Republicans to compromise; and (4) work with Representatives Nadler, Conyers, Frank, Gephardt, and Bonior to produce a more palatable House bill, or, if that is not possible, to garner the 20-25 additional House votes necessary to sustain a veto.

The proposals attached represent work by Treasury and the Department of Justice's Executive Office of the U.S. Trustee to advance the second prong of this strategy. The position that the Administration has taken on both means testing and reaffirmations has been rejected by the Republicans on the Hill. In an effort to be constructive, Treasury and DoJ developed these proposals as alternatives -- compromises that protect our core principles yet which might be able to garner greater support among Republicans and Democrats.

Means Test: Last year, we insisted upon giving the judges adequate discretion to review whether a debtor had the capacity to repay, notwithstanding the result of the presumptive means test. Creditors balked at what they perceived as wide discretion. Upon further review, we realized that the current test in both bills would entail extraordinary wasted effort and procedural burden in determining who does and who does not have the capacity to repay. Thus, our proposal would allow a preliminary determination that someone does not have the capacity to repay (and thus can stay in Chapter 7) without individualized analysis of their actual expenses for special categories like day care, medical expenses, etc. (The current bills require this time consuming analysis for all debtors, even though we expect only a fraction to be excluded from Chapter 7 by the test.) Once those that clearly have no capacity to repay have been screened out,

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our proposal would require review of the actual expenses of the remaining debtors. Moreover, we would continue to require that the court have adequate discretion to overcome a presumption of ability to repay under the means test. While the procedural improvements will yield important benefits in administrative efficiency, they also may create a new framework in which we can reintroduce the importance of bounded judicial discretion.

Reaffirmations: The current bills provide virtually no additional protection against coercive reaffirmations, other than a disclosure that the debtor has a right to a hearing. The Administration proposed that all reaffirmation agreements for unsecured debt (or for debt secured by goods worth less than \$500) be reviewed by the court. The creditors have objected to that proposal. Under this new proposal, the reaffirmation would be presumed to be appropriate if three standards are met: (1) the debtor is ***fully informed*** (as evidenced by a new disclosure about the terms of the credit reaffirmed and any new credit extended allowing the debtor to compare those terms to other credit available); (2) repayment of the debt does not impose ***an undue hardship*** (as evidenced by an analysis of the debtor's capacity to repay the reaffirmed debt after meeting all other nondischargeable debts); and (3) the repayment of the debt is in the debtor's ***best interest*** (with it presumed not to be in the debtor's best interest if the price of the debt is above certain high cost debt limits). In addition, other creditors whose debts are nondischargeable (e.g., former spouses and custodial parents) would be given standing to challenge whether or not the reaffirmation met these three tests. While this test will not prevent some debtors who can afford to reaffirm to do so under pressure from their creditor, it will reduce opportunities for inappropriate pressure and prevent coerced reaffirmations when they are most harmful to the debtor or other creditors.

Next Steps: If there is a consensus that these proposals would be acceptable alternatives, we would have to make a tactical decision about when to put them forward. We would try to vet the specifics with a small, select group of bankruptcy professionals and then share the ideas with staff of key members with whom we are working on Capital Hill.

At the Deputies meeting tomorrow, we will briefly review the positions taken by the Administration last year and the language on these issues in the pending bills. Then Treasury will describe these proposals and we hope to have a lively discussion about their advantages and disadvantages.

Attachments

Targeted Means Test Proposal

The principal goal of this proposal is to minimize the total cost of a means test for moving potential Chapter 7 filers who can repay some of their debt into Chapter 13. The benefit of moving filers who can repay is the increased debt repayments that would result. The direct costs of means testing include the costs to the panel trustees, bankruptcy administrators and filers of providing information for testing, the attorney's and administrative costs associated with challenges to trustees' findings, and the additional administrative costs of inappropriate referrals to Chapter 13 that result in failure. Beyond these costs are the burden of personal compliance, and the inherent rights of debtors to a fair hearing on their particular circumstances, if they are to be moved by the test. By targeting such hearings effectively, the proposal assures that virtually all debtors who truly can repay are moved fairly and at minimum cost to the system. Moreover, much as the IRS uses ability to pay guidelines today, the proposal allows for limited discretion by Trustees and judges to consider special circumstances of debtors, subject to presumptions created by the detailed guidelines. Thus, this proposal would reduce the costs of means testing compared to current bills, while still achieving comparable debt repayment.

Summary of Proposal

The resources expended to scrutinize debtors' ability to repay are related to the "payoff" in terms of expected repayment. Evidence on filers' actual ability to repay suggests that the best screen approach has two parts: low-cost screens for debtors who are unlikely to be able to repay, plus a more complete means test targeted to those who have some chance of being able to repay.

(I) *Very Low Potential to Repay:* Debtors who document incomes below 75% of the national median, adjusted for family size, are not subject to further means testing. Unless the totality of circumstances suggests abuse, it is automatically presumed that filing for Chapter 7 by such debtors is not abusive.

(II) *Low Potential to Repay:* Debtors with incomes between 75% and 150% of the national median are initially screened using a simple preliminary test of repayment capacity. This *preliminary* test calculates ability to repay the lesser of 30% of debt, or \$15,000, given that they can repay a minimum of \$50/month, based only on their income and the subset of allowable expenses included in the *formulaic* portions of the IRS standards, the National and Local Standards, determined only by income, family size, and area of residence. If they cannot repay according to this test, they certainly could not pay if the additional nonformulaic expenses allowed under the IRS' Other Necessary Expenses are included, and they are presumed to be filing appropriately in Chapter 7. Debtors who may be able to repay according to this screen are subject to a complete means test involving a detailed court review of the debtor's income and expenses, and any other special circumstances that substantially influence the likelihood of repayment.

(III) *Some Potential to Repay:* Debtors with incomes above 150% of the national median are fully examined for the ability to repay according to a complete means test involving a detailed court review of the debtor's income, expenses, and any special circumstances.

Unresolved Issues for Targeted Means Test Proposal

1. Inclusion of Child Support and Alimony Expenses in "Screen" Component of Means Test

The current screen requires the debtor only to provide information documenting income and family size, to keep the screen simple and minimize cost of applying it. Child support and alimony are considered, with appropriate judicial discretion for special circumstances, for all debtors subject to the full means test. If child support and alimony were included, some debtors who owe child support and alimony and are just above the "margins" of the screening test (at 75% and 150% of median income) would be more likely to have to go through the whole means test.

Pros: Allows some who owe child support and alimony to avoid a full, discretionary means test of their ability to repay.

Cons: Higher cost of screen, due to requirement that Trustee review all claims of child support and alimony obligations, not just those who are subjected to full means test. Also opens door to "fairness" arguments that other priority expenses (e.g., for elder parent or child with special needs) be included in the screen, as well as in the discretionary means test.

2. Stringency of repayment capacity in means test

Last year, we were aiming for a means test based on capacity to repay 30% of debt over a 36-month period. The current House and Senate bills use a longer time period (60 months) and lower repayment threshold (25%). We need to decide which numbers to use in our initial proposal.

3. Creditor exemption from penalties for sanctionable conduct involving debts under \$1,000

Administration believes there should be no exemptions from creditor sanctions. Current House and Senate bills provide an exemption in cases of debts less than \$1000, allegedly to prevent small businesses from being deterred from collecting debts in bankruptcy. Judiciary staff has signaled that they would be willing to live with an exemption only for small businesses. Should such a compromise be an initial or fallback position, or neither; and if so, what specific definition of small business would we use for the exemption?

4. Special provision for penalties against debtor attorneys that do not undertake due diligence to assure that debtor's claims are justified.

House and Senate bills include language that is unclear (perhaps deliberately so), but that may go beyond current law in creating a higher standard on debtor's attorneys. Administration could argue that this provision should be dropped - that the existing rule to encourage debtor due diligence is appropriate.

Pros: Eliminating this provision would eliminate a potential deterrent to debtor attorneys providing adequate representation to their clients in bankruptcy.

Cons: Sanctions on the debtors (rather than the attorney) are unlikely to work here, as they do in other areas of law, because a bankrupt debtor is judgment-proof. Parallelism concern: elsewhere in the bill, we endorse penalties on creditors for actions that are not substantially justified - so hard to argue against similar provision for debtors.

The following two issues are technical and can be resolved by the Working Group:

5. Should the US Trustee (Senate bill) or Panel Trustee (House bill) be responsible for followup filing

Pros for US Trustee: May have better incentives to bring motions in cases of inappropriate Chapter 7 filings, probably will be responsible for all contested cases anyway.

Pros for Panel Trustee: May know more about details of case, may lead to less of a new Federal cost burden.

6. Placeholder to allow modification of IRS standards

DOJ and Treasury believe that we want to keep the door open to possible technical modifications of the IRS standards, as Senator Torricelli suggested. However, we are unsure about how to draft legislative language that does not create too much of a burden for either Department.

DRAFT Reaffirmation Reform Proposal DRAFT**Current House and Senate Bill**

The current House and Senate bills require that creditors who seek reaffirmation of wholly unsecured debts provide a disclosure that the debtor is entitled to a court hearing, and that the debtors can waive their rights to hearings if represented by counsel. Thus the court must hold a hearing to determine whether the agreement should be approved if: (1) the debtor was not represented by counsel, as required by current law, or (2) has unsecured consumer debt and was represented by counsel but did not waive the right. The bills also require that the court must find that the agreement was not the result of a threat.

Administration Position

The Administration agrees with the Bankruptcy Commission that debtors need to receive full and complete disclosure of the facts of reaffirmation agreements, that many reaffirmations involve terms that are far worse than those available elsewhere, that the existing attorney affidavit procedure provides inadequate protection from unfavorable reaffirmations. Thus, the Administration has sought additional protection against unwise reaffirmations. The Administration has endorsed court review of all reaffirmations in which the debtor was particularly vulnerable. Such reaffirmations include unsecured debt and debt secured by small personalty items of little value that might represent a basis for coercion. Finally, believing that debtors with adequate information and protection against coercion were capable of making wise decisions even in the case of unsecured credit, the Administration does not support a ban on reaffirmations of unsecured credit.

Accordingly, the Administration supported the reaffirmation reform proposed in the Grassley-Durbin bill, S. 1301. The Senate bill required that the reaffirmation agreement contain a clear disclosure of the components of the reaffirmed debt—principal, interest, late fees, creditor's attorneys fees and other costs of collection. In addition, in cases where the debt was unsecured or was for purchase of a personalty item of original value less than \$250, the bill required the court to make a number of findings for approval, including finding that the agreement was in the debtor's best interest, did not impose undue hardship, was not the result of coercion, and was not excessive relative to collateral value. The Administration had sought greater protection than was included in the bill, by requiring that the court find clear and convincing evidence that the agreement was in the debtor's best interest and would not cause a hardship, and by applying the bill's provisions to debts for purchases of somewhat higher original value than \$250. One criticism of the Senate proposal was that the bill language did not provide clear guidance for courts to use in deciding whether reaffirmations met the conditions for approval, so that reaffirmations would be costly to review and so that diverse standards currently used by courts might continue to be applied.

This memo outlines enhancements to the Administration proposal on reaffirmations that address the concerns about feasibility and clear guidance. It also builds on the new information

on repayment capacity to be collected as part of the bankruptcy reform process – indeed, it applies the same results and standards to reaffirmations as to capacity to repay more generally – thereby limiting costs of reaffirmation review and assuring that priority debts will be paid. Thus, the enhancements to the reaffirmation proposal are largely self-executing.

Administration Proposal

The Administration supports the following reforms in bankruptcy law governing the approval of reaffirmations:

1. Court review of reaffirmations that are least likely to be in the debtors best interest involving unsecured debt and of secured personalty debt with original purchase price under [\$250/500], to determine that these reaffirmations are fully informed, voluntary, in the debtor's best interest, and do not pose undue hardship. In addition, costs and attorneys' fees cannot be added to these reaffirmations.
- Guidance to determinations that debtors have been fully informed in proposing reaffirmations and that the agreements are in debtors' best interests through an affidavit that would create rebuttable presumptions of full disclosure and best interests.
2. Rebuttable presumptions for whether the debtor has been fully informed and the reaffirmation does not pose an undue hardship, to streamline attorney and court reviews, and provide clear standards for all parties of what constitutes a nonabusive reaffirmation. The presumptions would encourage disclosure of all relevant financial terms of the reaffirmation so that the debtor is better informed, and would apply standards analogous to those in the means test to assess the debtor's likely capacity to repay while meeting other priority obligations.

The guidance is proposed both for courts' review where it is required or proposed to be required, and for reaffirmations in which debtor's attorneys must review and attest to the conditions.

3. No coercion: the Court must find that the agreement was not part of a threat.
4. Notice and standing for parties at interest, allowing affected creditors to object to a proposed reaffirmation that is likely to jeopardize payment of a priority debt.

Detailed Discussion of Proposal

The proposal for "no coercion" is the same as the finding required in the current House and Senate bills. We describe below the specific guidance for whether "full disclosure" has occurred, and for whether the reaffirmation constitutes an undue hardship for the debtor; and the additional standing to parties at interest to challenge proposed agreements..

Presumptions for affidavits/court approvals:

The Administration proposal creates specific conditions for a presumption of whether the debtor is fully informed about the financial implications of a proposed reaffirmation, whether the agreement imposes undue hardship and unduly jeopardizes priority debtors[, and whether the proposed reaffirmation is in the debtors best interest]. The proposal also requires a streamlined court review of a subset of reaffirmations that are least likely to be in the best interest of debtors and priority creditors. By providing clear guidance for courts, attorneys, and parties at interest in developing reaffirmations that are in the best interest of the debtor, *yet do not harm* creditors whose debt are nondischargeable, the proposal would improve the quality of all reaffirmations without imposing significant new administrative burdens on the bankruptcy system.

(1) *fully informed*: Debtor is presumed *not* to be fully informed unless the creditor who is party to the agreement discloses credit terms according to forms provided by the Judicial Conference and provides disclosures to court as part of filing. Disclosures on the form should include:

- the amount of the prepetition claim
- total amount of the reaffirmed debt, and component amounts attributable interest accrued, attorney fees, late fees, other costs relating to collection
- the monthly payment of the reaffirmed amount or, if the reaffirmation agreement extends new or additional credit, the minimum monthly payment on that amount
- annual percentage rate of interest (APR) and all other types of finance charges and their manner of calculation, including but not limited to late fees, service fees, etc, assuming that Regulation Z applies to the transaction and treats it as a refinancing; separately the same information for any new or additional credit extended¹
- date payments start
- total number of payments made to satisfy the reaffirmed indebtedness, if paid on schedule
- if secured, date any lien is released, if payments are made on schedule
- if secured, description of collateral, value, and basis for valuation

Disclosures that meet these requirements create a presumption of full information.

(2) *undue hardship*:

A proposed agreement is presumed to be undue hardship if:

(I) the debtor's monthly income, less

(II) the greater of (a) the debtor's actual monthly expenses, or (b) the applicable monthly standards issued by the IRS for the debtor's household size and income and the area in which the

¹ There is debate over the exemption granted to credit agreements that are the result of "court proceedings" in Regulation Z. This proposal does not suggest changing this exemption.

debtor resides, if these have been determined as part of a test of abuse of 707(b), or, if not, 1.4 times applicable monthly expenses under the National and Local Standards issued by the IRS for food, clothing and other items²; housing and utilities; and transportation; less

(III) monthly payments to be made according to existing contracts on nondischargeable debt (not already included in monthly expenses)

is less than the sum of monthly payments in all proposed reaffirmation agreements. This test builds on the ability to repay calculation that will be part of the means test. If this test suggests that the debtor does not have the capacity to repay the reaffirmed debt, then the proposed reaffirmation is presumed to be an undue hardship. If this test suggests that the debtor has the capacity to repay the reaffirmed debt, the proposed reaffirmation is presumed not to be an undue hardship. The disclosures in this section will be made on forms provided by the Judicial Conference.

The debtor may rebut a presumption of undue hardship by demonstrating unusual circumstances that, despite the presumption, justify the proposed agreement. For debtors who were not subject to the full Chapter 7 means test or who did not have adequate ability to repay according to the means test, this would require documenting expenses and required debt payments to provide evidence that the reaffirmation does not jeopardize payment of nondischargeable debts. Other parties at interest (i.e., affected creditors) may rebut a presumption that the agreement poses no undue harm by demonstrating that the debtor's future income and/or expenses are not described adequately in the information provided by the debtor on capacity to repay. Any such evidence provided by the debtor or priority creditors can also be used by the court as a factor in determining whether the Chapter 7 filing is presumed abusive, and/or the terms of any Chapter 13 repayment plan.

[POSSIBLE ADDITION - DIFFICULTY IS IN DECIDING WHAT INTEREST RATE IS CLEARLY QUESTIONABLE FOR ALL TYPES OF REAFFIRMATIONS...

(3) *best interest*: the agreement is presumed *not* to be in the debtor's best interest unless the terms of the agreement conform to the intent of the Home Ownership and Equity Protection Act assuming it applied to reaffirmations³, including, in particular, if the reaffirmation includes fees, or includes an effective APR more than 10 percentage points [or other appropriate number to be worked out with Fed guidance] above the average APRs of equivalent credit as reported by the Federal Reserve Board.]

Notice and standing for other parties at interest

² According to the data in the BLS's Consumer Expenditure Survey, average total consumer expenditures are about 40% larger than annual expenditures for the items covered in the National and Local Standards.

³ This proposal does not suggest modifying Regulation Z--see preceding footnote.

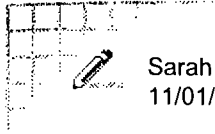
(1) *Notification*: Debtor must notify creditors whose claims are not dischargeable of any proposed reaffirmation agreement with sufficient time to allow such creditors to object to the court's approving an agreement. [The same rules governing bankruptcy notice for creditors could be applied here.]

(2) *Standing for parties at interest*: Creditors with nondischargeable claims must have an opportunity to object to a proposed agreement. We propose modifying Sec. 524 to add a new subsection (e)(1), stating that a party in interest may object to the approval of an agreement because of substantive or procedural defects. If an objection is made, the court must hold a hearing to determine whether the agreement should be approved.

(3) *Fee shifting*: The court may award a creditor all reasonable costs in bringing an objection, if the court grants the objection and finds that the position of the debtor who proposed the agreement was not substantially justified (as guided by the presumptions described below). The court may award the debtor all reasonable costs in contesting an objection brought by a party in interest if the court does not grant the objection and the court finds that the position of the party in interest was not substantially justified, or the party brought the objection solely for the purpose of coercing a debtor into waiving a right guaranteed to the debtor.

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Record Type: Record

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Subject: Minimal Bankruptcy Needs

I would argue that -- of all the amendments we want to see -- we absolutely need to have three when the bill passes and a fourth would be desirable. I would argue our strategy ought to be aimed at getting these changes in the final bill, although in public we ought to be supportive of anything that the Democrats put forth, since many are offering amendments that we proposed.

(1) **Reaffirmation deal.** It appears that Grassley is going to stick with Reed on the Administration's negotiated proposal. We need to assure that it survives conference. It will allow us to say that we have dealt with one of the greatest risks of consumer abuse stemming from the new bill. [What should we do to get that. Would a conversation between Gene and Grassley help now?]

(2) **Block efforts to make debtors (especially below median income debtors) to be subject to "totality of the circumstances" motions by creditors,** as part of any "below median income safe harbor." From the beginning, we have been worried about giving creditors the ability to threaten or coerce debtors. These motions can be brought by trustees under the bill. But if creditors can bring them, they can threaten consumers that they will challenge their bankruptcy filings. For below median income debtors -- who genuinely won't have the ability to repay -- this could be especially harmful. Under last year's conference report and this year's Senate bill, creditors can not bring these motions. But, in response to our insistence on a "safe harbor for below median income debtors" to prevent them from being required to go through the paperwork and hassle when they have virtually no capacity to repay, Grassley proposed a "manager's amendment" that gave them a "safe harbor" from paperwork and means test, but subjected them to the "totality of the circumstances" test. Schumer wants to take on this fight. We want to win a full safe harbor -- but most essential is keeping out the totality of the circumstances motions.

(3) The meager **Torrecelli amendment on credit card disclosures.** While woefully inadequate, this is likely to survive since most of the industry has blessed it. If so, we can point to something new that wasn't there when we expressed concern.

(4) Also desirable would be some of the **carve-outs from the means test** that Gene proposed -- re displaced workers, domestic abuse, expenses for non-dependent family members, and adoption. We can say that clarified how bill applied in particularly problematic cases.

If we get these four changes, we could let the bill become law (or sign it) with serious concerns about its impact, but with a colorable argument that we got some protections. Consumer groups won't buy it -- since the means test is their focus rightly -- and we'll have gotten no meaningful changes.

Anyone got any better ideas? Different priorities?

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BANKRUPTCY
September 9, 1999

I. Report of Outreach to Industry

- Tentative GE meeting Friday

II. Senate Schedule

III. Republican Strategy

- Manager's amendment
- Torrecelli credit card amendment
- Reaffirmation "deal" with Administration (possibly in jeopardy)
- Pass homestead amendment on floor vote
- UC limited number of other Democratic amendments on the floor

IV. Democratic Plans

- Over 50 proposed amendments
- Minimum Wage (Kennedy)
- Farm (Dorgan)?
- No privacy amendments
- Numerous bankruptcy-related proposals, including most of the Administration's (See list)
- Amendments preventing discharge of gun control, tobacco, and clinic access judgements in bankruptcy
- Expect list to be significantly winnowed down
- A few could be accepted by UC or incorporated in the manager's amendment

V. Administration Strategy

- Continue working with Democrats on amendments
- Do not put the President or First Lady further into the fray
- Look for opportunities to make modest improvements
- Possible homestead push?
- Expect Conference to drop more moderate Senate provisions

VI. Statement of Administration Position

- Timing (beginning of debate or before final passage)
- If later, send separate guidance on amendments?
- SAP content? Current draft:

".... S. 625, as reported, reflects some improvements over H.R. 833 as passed by the House. The Administration, however, continues to have serious reservations about S. 625 and strongly opposes some of its key provisions. Some of the Administration's major concerns would be addressed by amendments that we understand will be offered on the Senate floor. The Administration remains hopeful that bipartisan cooperation will result in responsible bankruptcy legislation that the President can enthusiastically sign."

Attachments

- Administration's Proposed List of Amendments (indicating who will offer)
- Complete list of known potential amendments (indicating which might be accepted)
- Draft SAP

Proposals for Modest Improvements to S. 625

As of September 7, 1999

Means Test

1. Changes Already Made in the House Bill: Include additional factors in the means test that determine repayment capacity and success in Chapter 13, *and that are already included in the House bill.*
 - a. Allow administrative expenses and reasonable attorneys' fees of 10 percent of *Schum.* projected payments under a chapter 13 plan.
 - b. Allow continuation of educational expenses and charitable contributions, and exclude benefits received under the Social Security Act. *Kennd*
 - c. Allow additional expenses up to 5% of additional food and clothing expenses as in the House bill, and expand this provision to *all* National and Local formulaic standards. This provision is derived from a more flexible IRS enforcement guideline that *automatically* allows deviations that are small in magnitude to the formulaic expense standards without requiring substantial justification. It prevents a strict standard of review from being applied to individuals whose estimated repayment capacity from the means test exceeds the repayment threshold by only a few dollars, when they need those dollars for their usual expenses. *?*
2. Allow Expenses for Victims of Domestic Violence, Retraining for Displaced Workers, Adoption, and Care of Nondependent Family Members: Clarify that certain expenses should take priority over credit card debts and "reasonable and necessary" expenses under the means test:
 - a. Allow continuation of reasonable expenses for the support of nondependent *Feng* family members. For example, many households provide important support and care for elder parents, allowing them to keep living in the community, but do not provide enough support for the parent to be counted as a dependent.
 - b. Allow displaced or unemployed workers seeking to return to work reasonable expenses and adjustments in income for education, equipment, relocation, and other expenses related to moving from welfare, disability, or unemployment to work. Such expenses may substantially reduce government welfare costs and increase repayment capacity in the long run; disallowing them could prevent debtors from working their way out of debt. *Ken*
 - c. Allow expenses associated with adoption. *Dodd*

- d. Allow additional expenses and income adjustments associated with protection of the debtor and family from domestic violence. Leahy
3. Incorporate Rules Used In Applying the IRS Standards to Tax Collection to Increase Bankruptcy Collections and Fairness:
- a. Allow expenses above formula amounts if the debtor can show that, if such expenses were not allowed, the debtor would in fact have higher necessary expenses and thus less disposable income for debt repayment. For example, if the debtor is paying rent above the allowable amount but penalties for termination of the lease and moving expenses would result in less overall disposable income, the additional rental expense should be allowed over the life of the lease. If the debtor is paying rent above the allowable amounts but has low child care expenses and can show that, if forced to move, higher child care expenses would more than offset savings from lower rent, then the additional rent should be allowed. Schum
- b. Allow low expenses in some formulaic expense categories to offset high expenses in others. For example, some debtors have above-formula housing expenses but below-formula transportation expenses, because they reside close to their job. Such expenses would be considered appropriate if the total actual expenses for both categories were less than the total formulaic expenses for both categories. Schum
4. Reduce unnecessary costs and inefficiency in the reformed bankruptcy system: Streamline application of the means test and reduce costly paperwork collections without impacting debt repayment under the new system.
- a. Debtors with incomes of 100-150% of median should not be required to document all of their other necessary expenses unless a preliminary screen based on formulaic expenses and nondischargeable debts shows that they can repay. Dorbi
- b. Eliminate provisions requiring debtors to file unnecessarily three years of tax returns (and requiring expensive storage and retrieval systems), requiring filing only when requested by creditors. Leahy
5. Create a True Safe Harbor for Below-Median Income Debtors: The current bill, even as modified by the manager's amendment, would require low-income debtors to file extensive documentation of expenses that will not be used for any bankruptcy purpose. These additional filings create unnecessary paperwork and a barrier to bankruptcy for low-income filers with no likely capacity to repay. There is simply no justification for leaving these requirements in place. Schumer
- a. Only require below-median income debtors to document their income; do Dur

not require them to provide full means test documentation (since not subject to means test motions). Also – technical amendments to existing safe harbor language.

Schumer
Dud!

6. Clarify that small variations are permitted from the means test housing, food, and transportation expense allowances where reasonably necessary [where reasonable and necessary?] to ensure fairness: Many households have expenses that are somewhat higher than the median for reasons that are hardly extravagant. Small variations should be permitted where necessary for fairness.

- a. Allow additional housing expenses of up to 10% for gross rent and for housing costs other than mortgage if reasonably necessary. Without such a variance, some debtors could be arbitrarily forced to leave their homes, communities, school districts, when their housing expenses are slightly above the county median yet are not unreasonable or extravagant, while others less well off would not suffer the same fate. For example, according to the 1990 Census, the median gross monthly rent in the Census Tract in North Woodhaven, Queens, was \$640, 15 percent larger than the median rent for the county. Applying the housing standards inflexibly could force debtors of this community to move far from their jobs, or forego other necessary expenses. Yet this is not a particularly wealthy community – its median income was less than the median income of the county as a whole (\$34,200). By comparison, the median gross rent in the Census Tract just north of Howard Beach is less than the county median, so far fewer filers from this community would have to move. Yet their resources are in fact greater—their median income is \$2,000 above the county median income. What is fair or rational about forcing lower income debtors to move from Woodhaven, but not higher income debtors from Howard Beach?

Schumer ???

- b. Allow additional adjustments to food expenses of up to 10 % if reasonably necessary. Many households have above-average food expenses for perfectly ordinary reasons. For example, debtors who have children who are older than average also have food expenses that are 15 % more than the average. This variance would allow consideration of the ages of the children to be feed on the food allowance.

Dodd ??

- c. Allow adjustment of 15% in transportation expenses other than ownership costs of vehicles if reasonably necessary. Non-ownership transportation expenses (e.g., bus fare) increase enormously as the size of the debtor's family grows, nearly independently of the number of owned or leased cars. Indeed, households with fewer cars often have much higher non-ownership expenses. Such expenses are even larger when the additional family members also earn income for the family; and so not allowing them could substantially reduce a household's ability to repay debt. In addition, many debtors have work situations

that require high transportation expenses. For example, the non-ownership expenses are about 15% higher for families of 4 people than for 2 people; public transportation expenses are nearly 30% higher for the same size difference.

6. Develop means test standards appropriate for bankruptcy, based on the IRS guidelines, without increasing judicial discretion.

- a. Treasury and Justice should be required to develop expense standards appropriate for bankruptcy based on the IRS guidelines. Chairman Hyde made a similar proposal, pointing out that the IRS standards were designed for tax collection in IRS processes with substantial administrative discretion, not debt repayment after bankruptcy in courts with more limited judicial discretion. In this context, more carefully tailored standards are required. The current bill, as amended by the managers' amendment, fails to authorize DoJ and Treasury to develop bankruptcy-specific expense standards.

Schum
Dud

7. Improve the Accuracy of the Means Test (as a test of capacity to repay).

- a. Amend Section 704 to allow U.S. Trustees to consider required payments of arrearages and other debt expenses and administrative costs and attorneys fees not included in the means test in determining capacity to repay. [Query: Does Schumer want to amend the means test or allow Trustees to consider this fact in making a motion?] Arrearages and administrative costs can be large and will be required to be repaid under a Chapter 13 repayment plan. A test that assesses capacity to succeed under a Chapter 13 plan that doesn't take into account these expenses arrearages will not accurately identify those truly able to succeed, and will instead increase the number of failed Chapter 13 plans.

Schum

9. Improve predictive capacity of means test by taking into account expected future changes.

- a. Allow the U.S. Trustees to consider expected changes in future income or expenses compared to the past 6 months (e.g., from expected job loss, training completion, or changing child care needs) in determining capacity to repay. This amendment would minimize the referral of cases to Chapter 13 that simply will not be able to confirm a successful plan.

?

Credit Card Disclosures

The most effective way to reduce the number of bankruptcies is to give consumers the

information they need to manage their credit card debts effectively -- information that creditors can provide at low cost. An amendment expected to be offered would provide a general disclosure to all consumers and more specific information only if they call an 800 number. While we believe more tailored disclosure is appropriate for all consumers, intermediate measures to target those most in need or seeking more information would:

1. *Provide Greater Disclosure for At-Risk Debtors:* Provide automatic disclosures about the financial implications of making only a minimum payment, with the monthly credit card statement, at least to consumers who are most likely to benefit from this information -- i.e., those who made the minimum payment only in the previous month (or 2 months). If this information can be custom-generated for any consumer who calls an "800" number, which is costly to set up and staff, it could certainly be provided automatically to a limited number of easily-identifiable "high-risk" consumers. Do
2. *Provide Better Information to those Who Call the 800 Number:* Borrowers who are interested in the impact of making minimum payments may better understand the issue if told the total dollar amount that they would be required to repay, if making only the minimum payment, in addition to the total number of payments that it would require. no

Reaffirmations

[If agreement can be reached on the proposed Sessions-Reed amendment without creating any loopholes to its important protections, and if Senate leadership will commit to protect the amendment in Conference, it should be strongly supported.] Sessions-Reed

Nondischargeable Debt

The Bankruptcy Code makes debts nondischargeable only where there is an overriding public purpose, as with debts for child support and alimony payments, educational loans, tax obligations, or debts incurred by fraud. The Administration remains concerned that additional credit card and other nonpriority debts that are made nondischargeable by S. 625 will compete after bankruptcy with these societal priorities. There is no evidence of widespread abuse of credit cards on the eve of bankruptcy, particularly for low-income filers.

1. *Change provision for dischargeability of cash advances from \$750 to \$1000 within 70 days.* Cash advances are generally used for necessary not luxury expenses. This is still a tightening of dischargeability from current law. Do
2. *Retain current law provisions on nondischargeability for below-median income debtors.* Risk of abusive bankruptcy planning by these debtors is low, while the need for cash or juggling debts on the eve of bankruptcy is likely to be greater. no

Loopholes for Wealthy

Fair bankruptcy reform should close loopholes that allow many wealthy debtors to avoid their responsibility to repay a significant portion of their debt. Bankruptcy reform should not impose very strict requirements of debt repayment on moderate- and low-income debtors, while allowing wealthier debtors to shelter many hundreds of thousands of dollars in assets.

1. Include a reasonable cap on homestead exemptions. Any limit, even a very high one, ^{Kohl} would be an important step toward increasing debt repayment by those who really can afford to do so.
2. Include a "bright line" time limit on assets transferred to the homestead on the eve of bankruptcy, for example within 365 days. The current Senate bill reduces the value of the homestead exemption on purchases within 730 days, provided that intent to defraud is demonstrated. But "eve of bankruptcy" provisions that do not require proof of intent are imposed by the bill on low-income debtors. There shouldn't be a double standard. ^{n"}

Notes indicate likelihood of passage
if not marked, prospect is remote.



Record Type: Record

To: sarah rosen wartell/opd/eop@eop
cc: Brooke B. Livingston/WHO/EOP@EOP
Subject: Updated Bankruptcy Amendment List

Substitute

Durbin -- Although it much less likely than before, Durbin is still considering offering -- or more likely just floating -- last year's Senate bill, S. 1301, as a substitute.

Means Testing

Schumer/Durbin -- The safe-harbor amendment -- protection for debtors who earn below the median income from creditor motions of all kinds, trustee 707(b) motions, and from the paperwork requirements of the means-test. *partial likely*

Durbin -- The efficiency amendment -- for debtors who earn between 100-150 percent of the median income do a cursory evaluation of their ability to pay prior to running the full means-test on these debtors. *possible but not likely*

Schumer -- Giving Treasury the express authority to promulgate bankruptcy specific standards.

Schumer -- An amendment expressly noting that the flexibility employed with the IRS standards should be used in the bankruptcy context as it is in the tax collection context. *possible but not likely*

Schumer -- The accuracy Amendment -- expressly allowing the U.S. Trustee to consider arrearages, administrative expenses, attorneys fees, etc. in determining the debtor's ability to repay. *partial likely, read possible*

Feingold -- Part of the sympathetic debtor amendment -- nondependent family members (perhaps combined with an express protection for long-term care expenses). *possible*

Kennedy -- Part of the sympathetic debtor amendment -- displaced workers. *possible*

Dodd -- Part of the sympathetic debtor amendment -- adoption expenses. *possible*

Leahy -- Part of the sympathetic debtor amendment -- domestic abuse expenses. *possible*

Durbin -- Durbin is still tossing around the idea of offering the Hyde amendment or parts of the Hyde amendment. As noted above, they are working with Schumer and us on other means test amendments, but they still appear to believe that the Hyde amendment might win due to the rhetorical advantage of invoking Hyde's name and his speech on the House floor.

Dodd -- An amendment that would protect any money that is supposed to be earmarked for kids as the debtor goes through the system.

Reaffirmations

Reed/Sessions -- If the deal holds up, they will likely offer the compromise Treasury was able to secure. *will pass if offered*

Kennedy -- Kennedy's office has softly implied that if they are not happy with the Reed/Sessions amendment that they may offer the reaffirmation language from last year's Senate bill.

Credit Card Disclosures

Torricelli-Grassley -- They will offer the credit card disclosure amendment that Torricelli negotiated with the credit card companies. *will pass*

Sarbanes/Durbin -- They are contemplating everything from offering the disclosure provisions from last year's Senate bill to a series of improvements to the Torricelli-Grassley amendment.

Dodd -- They are considering doing a stronger credit card disclosure amendment (in particular targeting at risk debtors with more specific and automatic disclosures).

Schumer -- Teaser-rate disclosures (if not content with this provision in the Torricelli-Grassley amendment).

Reed -- Disclosure that debt greater than the security interest in a home is not deductible (if not in the Torricelli-Grassley amendment).

Reed -- No penalty or cancellation if pay credit card balance off on time (if not in the Torricelli-Grassley amendment).

Durbin -- Predatory lending; if violate TILA, lose rights in bankruptcy.

Homestead

Kohl/Sessions -- 100,000 dollar cap. *will pass (drop in conference)*

Cram Downs

Kohl -- 6 months on all goods with a purchase money security interest.

Nondischargeable Debt

Dodd -- will likely tackle both the cash advance and dischargeable debt used to obtain nondischargeable debt issues with adjustments to the time and money amounts.

Consumer Credit Counseling

Durbin -- A two part amendment: (1) allowing the debtor to satisfy the credit counseling requirement over the phone; and (2) requiring court approval before a filing can be dismissed for failure to satisfy the credit counseling requirement. *partial likely, all possible*

Feingold -- They may do an amendment expanding the definition of exigent circumstances (in particular if Durbin is unsuccessful in getting his amendment accepted).

Hatch -- An amendment limiting what information a credit counselor can share with a credit reporting agency. *likely*

Women and Children

Dodd -- As noted above, Dodd is likely to do some nondischargeable debt amendments.

Dodd -- As noted above, Dodd is likely to do a carve-out for money owed for women and children in the means-test.

Dodd -- An amendment expanding the definition of household goods and requiring a hearing to rebut a presumption in favor of the debtor on this issue.

Dodd -- An amendment that would protect the refund obtained by a debtor via the Earned Income Tax Credit from being included as income in the means-test.

Miscellaneous

Kennedy -- Minimum Wage *possible ??*

Kennedy/Schumer -- An amendment protecting social security benefits (the same amendment that Sheila Jackson Lee got accepted on the House floor). *likely*

Kennedy -- The solicitation of minors amendment -- if younger than 21 and a dependent as defined by the IRS, then would have to show independent income or have parent's signature to obtain a credit card. In addition, a disclosure of the common law principal that most contracts made with a minor are unenforceable.

Kennedy -- Chapter 11/labor amendment(s) -- an amendment or series of amendments to address some of the business bankruptcy provisions with which labor is concerned.

Durbin -- The nondischargeability of damage awards levied against gun manufacturers. *?*

Feingold -- No mandatory, binding arbitration of disputes between a debtor and a credit card company.

Feingold -- IFP *likely*

Feingold -- Reinstatement of the apartment tenant automatic stay.

Feingold -- Family farm amendments -- Four small amendments increasing the dollar maximum and definitions of "family farm" to expand the number of small farmers who are eligible for Chapter 12.

Feingold -- The nondischargeability of FEC fines.

Cleland -- Disclosure of mandatory, binding arbitration clause contained in most credit card agreements.

Leahy -- Tax returns -- an amendment that would provide that a debtor would have to provide proof of income, but that s/he would only have to provide *three years* of tax returns if a party in interest makes such a request (as opposed to an automatic requirement).

Leahy -- An amendment clarifying a debtor's right to judicial review (as suggested by the Judicial Conference). *possible*

Schumer -- The FACE amendment.

Dodd -- Protection of educational savings accounts. *possible*

Kohl -- The back-pay amendment -- insuring that more of the wages of employees (who are creditors of the estate) of a business that files for Chapter 11 are paid out to the employees at a higher priority. *possible*

Kohl -- The employee benefits contributions amendment -- protecting the money employees make into the *possible*

employee benefit accounts when the employer files for Chapter 11.

Dorgan -- Possible substantive Ag amendments.

Feinstein/Biden -- An amendment increasing filing fees to pay for the increase cost to the bankruptcy system created by this bill. *in some form likely*

Wellstone -- The payday loan amendment -- if make a "payday" or some other very high interest loan, lose rights in bankruptcy as to that loan.

Wellstone -- An amendment requiring banks with over \$200 million in assets to provide free checking accounts to low income persons.

Hatch/Biden -- An amendment capping the amount of a debtor's retirement savings that can be protected during bankruptcy (likely at \$500,000). *possible*

Draft -- Not for Release

September 8, 1999
(Senate)

S. 625 - Bankruptcy Reform Act of 1999
(Grassley (R) Iowa and eight cosponsors)

The President supports bankruptcy reform that is balanced, would reduce abuses of the bankruptcy system, and would require debtors and creditors alike to act responsibly. He is disappointed that the House failed to produce legislation that he could support. S. 625, as reported, reflects some improvements over H.R. 833 as passed by the House. The Administration, however, continues to have serious reservations about S. 625 and strongly opposes some of its key provisions. The Administration's objections to this bill are explained in detail in the Attachment.

Many of the Administration's major concerns would be addressed by amendments that the Administration understands will be offered on the Senate floor. The Administration's views on the anticipated amendments are also contained in the Attachment. The Administration remains hopeful that bipartisan cooperation will result in responsible bankruptcy legislation that the President can enthusiastically sign.

* * * * *

Detailed Administration Views on S. 625 and Anticipated Floor Amendments

Access to Chapter 7. Any means test used in bankruptcy proceedings should deny access to Chapter 7 bankruptcy procedures only to those debtors who genuinely have the capacity to repay a portion of their debts successfully under a Chapter 13 repayment plan. S. 625 in its current form would limit access to Chapter 7 to those debtors who meet a relatively inflexible and arbitrary means test. The Administration strongly opposes this provision. Debtors who may be denied a discharge of their debts must be given a meaningful and realistic opportunity to have their specific circumstances considered by bankruptcy courts with appropriate, limited discretion to determine whether they genuinely have the capacity to repay a portion of their debts.

As reported, S. 625 would apply rough guidelines, developed by the Internal Revenue Service (IRS) for tax repayment plans, as standards for determining debtors' ability to repay, with exceptions only for expenses that are "reasonable and necessary." While some expense standards should be used to guide the determination of ability to repay, they should be tailored for bankruptcy. The same set of standards simply cannot be used *[why not? not clear]* in both bankruptcy and tax collection, which involve very different purposes and systems of judicial review. The Administration believes that the IRS expense formulas can be used as a starting point for developing appropriate bankruptcy guidelines, but that each system would be best served by its own appropriate standards.

As House Judiciary Committee Chairman Henry Hyde has said, the use of IRS guidelines without flexibility "depriv[es] debtors and their families of the means to pay for their basic needs." **[Confirm quote from NYTs – accurate in context.]** As Chairman Hyde noted on the House floor, "The cost of food in Omaha, Nebraska, or Boise, Idaho, is different than in downtown Manhattan. So what is realistic about an inflexible standard?"

[Another example illustrates the arbitrary impact of these formulas, treating similarly situated debtors differently. According to the 1990 Census, the median gross monthly rent in the Census Tract in North Woodhaven, Queens, was \$640, 15 percent greater than the median rent for the county. Applying the housing standards inflexibly could force debtors of this community to move far from their jobs, or forego other necessary expenses. Yet this is not a particularly wealthy community -- its median income was less than the median income of the county as a whole (\$34,200). By comparison, the median gross rent in the Census Tract just north of Howard Beach is less than the county median, so far fewer filers from this community have to move. Yet their resources are in fact greater--their median income is \$2,000 above the county median income. What is fair or rational about forcing lower income debtors to move from Woodhaven, but not higher income debtors from Howard Beach?]*[Is this a compelling argument?]*

Finally, all parties should be able to agree that any means test should be implemented efficiently. Burdensome filing and hearing requirements that lead to little or no additional debt

repayment are not in the interest of debtors, creditors, or taxpayers.

The Administration understands that a series of amendments will be offered to improve the fairness of the means test. The Administration supports these amendments, including: [list subject to change]

An amendment by Senator _____ to incorporate improvements in the means test that were adopted by the House;

Amendments by Senators _____ and _____ to clarify the treatment under the means test of expenses for victims of domestic abuse, adopting a child, displaced or unemployed workers retraining or moving for employment, and caring for a non-dependent parent or relative;

An amendment by Senator Durbin to reduce unnecessary costs and inefficiency in the reformed bankruptcy system by streamlining application of the means test and reducing costly paperwork collections without affecting debt repayment under the system;

An amendment by Senators Schumer and Durbin [?] to create an effective safe harbor from application of the means test for debtors with incomes below the national median;

An amendment by Senator Durbin [?] to authorize the Treasury Department, in consultation with the Executive Office of the United States Trustees, to develop customized guidelines for use in the means test based on the IRS guidelines;

- An amendment by Senator Schumer to improve the accuracy of the means test calculation by counting all required expenses (administrative costs, reasonable attorneys fees, and arrearages on other debt) in calculating capacity to repay under the means test.
- An amendment by Senator _____ to adopt policies, which are used by the IRS in applying the IRS guidelines for tax collection, for use in the bankruptcy means test, so as to increase collections and enhance fairness;
- Amendments by Senators _____ to clarify that small variations are permitted from the means test for housing, food, and transportation expense allowances where reasonably necessary [where reasonable and necessary?] to ensure fairness; and
- An amendment by Senator _____ to confirm the U.S. Trustees' discretion to consider expected changes in income or expenses in evaluating a debtor's challenge to the presumption that the debtor has the capacity to repay as calculated under the means test.

Consumer Information and Protection. The Administration continues to believe that reform must address the factor that is most strongly correlated with the rise in personal bankruptcy: rising levels of consumer debt. Americans now receive more than 3.5 billion credit card solicitations per year, many of which are marketed to encourage consumers to carry high

4.

balances and incur large interest charges. The most effective way to reduce the number of bankruptcies in this new financial era is to give consumers the information they need to manage their credit card debts effectively, recognizing the creditors' superior information and bargaining ability. Consumers must be given clear information on the terms of their credit and the financial implications of not paying off their credit card balances.

The amendment to be offered by Senators Grassley and Torricelli addresses some abusive credit practices, such as failure to disclose "teaser" rates clearly. While this is an improvement over H.R. 833, much more should be done. Under the Grassley-Torricelli amendment, creditors must provide *[specified?]* information to debtors who call the toll-free number on the statement. The amendment creates a system that is unnecessarily burdensome for consumers who may be reluctant to call their credit card company if they are worried about their finances or are pressed for time. The Administration supports the ____ amendment, which would require that the information be provided in a manner that would be easier and more reliable for consumers to use by including it automatically on credit card statements. Providing the information in this manner *[would/could/would likely]* also be less costly to creditors than the requirement to make this information available to consumers who call a toll-free number. *[can we say this?]* [The Administration also supports other amendments that are designed to address abuses in credit card solicitation.][Note: We should specify the amendments or drop this reference.] [Treasury reviewing the new Dodd kiddie-credit amendment.]

Abusive Creditor Practices. Much evidence shows that debtors often reaffirm unsecured debt and low-value secured debt on unfavorable terms even though they do not have the means to meet their own necessary expenses and make more important debt payments, placing such priority debts as child support and alimony obligations at risk. Such reaffirmations frequently are the result of insufficient or misleading information or threats from creditors. S. 625 as reported does little to address these abuses. If we are to provide substantial new opportunities for creditors to challenge debtors' use of the bankruptcy system under Chapter 7 of the Bankruptcy Code, we must limit abusive creditor practices such as coercive reaffirmations and violations of the automatic stay against collection actions. Hence, the Administration supports the amendment of Senators Sessions and Reed, which protects debtors by giving them adequate information for decisions about significant reaffirmations of unsecured and low-value secured debt.

Cramdowns. S. 625 also changes the lien stripping or "cramdown" provisions in current law governing a Chapter 13 bankruptcy, under which a secured debt becomes nondischargeable only up to the value of the security interest at the time of bankruptcy. The Administration agrees that lien stripping should be limited to automobile loans incurred in the period preceding bankruptcy to prevent abuses, but believes that the provisions in the Senate bill are excessive. While the Administration strongly prefers the Senate provisions to the extreme prohibitions in H.R. 833, the five-year prohibition on lien stripping on automobile debts in the current bill will do little more to deter bankruptcy abuses than a more reasonable time limit. Instead, the prohibition will significantly reduce repayment of priority, unsecured debts like child support and taxes. The Administration understands that Senator _____ [Kohl? Sessions?] will offer an amendment that would provide appropriate cramdown relief. The Administration supports this

amendment.

Nondischargeable Debts. The Bankruptcy Code makes debts nondischargeable only where there is an overriding public purpose, as with debts for child support and alimony payments, educational loans, tax obligations, or debts incurred by fraud. The Administration strongly prefers the provisions in S. 625, which offer some protection for child support and alimony, to those in H.R. 833. But the Administration remains concerned that additional credit card and other nonpriority debts made nondischargeable by these provisions will compete after bankruptcy with child support, alimony, and other societal priorities like educational loans and taxes. The amendment to be offered by Sen. _____, which the Administration supports, would address this concern by _____.

Loopholes for the Wealthy. The Administration supports changes that would close loopholes in bankruptcy law, such as unlimited homestead exemptions [and the exemptions from repayment requirements for individuals who are able to file for bankruptcy under Chapter 11 – **do we need to mention this issue – isn't it in manager's amendment? Some bankruptcy professionals disagree?**], that allow many wealthy debtors to avoid their responsibility to repay a significant portion of their debt. Bankruptcy reform should not place a greater responsibility for debt repayment on moderate- and low-income debtors than it does on high-income debtors. The Administration supports the _____ amendment to place a reasonable limit on homestead exemptions.

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**Presidential Life
Insurance Company**

Fax



To: Mrs. Hillary Clinton

From: Herbert Kurz

Fax: 202-456-6244

Date: October 21, 1999

Phone:

Pages: (Including cover) 9

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NYACK, NEW YORK 10960
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Herbert Kurz, Chairman of the Board

October 21, 1999

First Lady Hillary Rodham Clinton
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20500

Dear Mrs. Clinton:

I just received a report from the Center For Insurance Research that further underscores the need to excise the redomestication provision from the Banking Bill before it becomes Law. Attached is the press release summary (there are an additional 40 pages of charts, tables, etc.).

Sincerely,

A handwritten signature in black ink, appearing to read 'Herbert Kurz'. The signature is fluid and cursive, with a long horizontal stroke extending to the left.

PRESS RELEASE

For Immediate Release:

October 21, 1999

For more information contact:

Jason Adkins or Paula Isola (617) 367-1040
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**PROVISIONS IN FEDERAL BILL H.R. 10 WILL FACILITATE
LOSS OF OVER \$100 BILLION
TO 35 MILLION POLICYHOLDERS ACROSS COUNTRY**

**New Financial Analyses Quantify Damage of Federal
"Redomestication" Provisions By State**

Cambridge, MA -- Over 35 million policyholders of mutual insurance companies nationwide are at risk of losing \$94.7 billion in equity, or \$1,700 each, according to an analysis of recently enacted state laws the impact of which will be exacerbated by the Financial Services Act of 1999 now being considered by Congress. The detailed state-by-state analyses by the Cambridge-based Center for Insurance Research reportedly show that the federal provision in H.R. 10 that facilitates mutual insurance company conversions to stock form without compensation to policyholder-owners (as traditional law requires) will have a devastating impact on consumers in every state. The federal provision would allow mutual insurers based in New York State alone -- where such conversions have been rejected by the Legislature -- to deprive 17.5 million policyholders nationwide of \$28 billion.

The adverse impact of the federal bill, which promotes the mutual-to-stock conversions in which policyholder-owners are not compensated, is best seen in contrast to the proposed traditional stock conversions of two of the nation's largest mutual insurers. Prudential and John Hancock are both preparing to convert to stock next year, and will distribute a combined estimated \$30 billion to 15 million policyholders nationwide in doing so. Had just these two mutual insurers attempted to use the novel mutual holding company conversion method facilitated by H.R. 10, none of these

mutuals' \$30 billion in assets would have been returned to their policyholder-owners upon conversion. (Prudential is based in New Jersey where the novel conversions were outlawed, but under H.R. 10 it could move to another state and return none of its \$24 billion in assets to policyholders.)

"H.R. 10 is purportedly designed to strip away the decades-old legal barriers between the banking and insurance businesses to benefit the market and consumers alike. However, it contains a harmful provision that facilitates the controversial-type of mutual-to-stock conversions which threatens to deprive millions of consumers of billion of dollars in property rights," Adkins said. "The devastating aspect of that insurer-backed provision has been kept from the public and members of Congress until now," he said.

For the first time, this analysis allows the public to measure the potential adverse impact of the controversial-type mutual conversion laws and to examine how the "redomestication" provisions (Sections 311-316) of H.R. 10 will magnify the public harm if it becomes law. Those provisions of H.R. 10 would allow mutual insurance companies based in states that do not permit the controversial form of mutual-to-stock conversions to move to another state that permits it.

The Center's analyses show that about 52% of the nearly \$100 billion in potential losses from mutual conversions would be suffered by policyholders in the 27 states that have rejected or not enacted mutual holding company conversion legislation. The analyses further show, as discussed above, that 17.5 million policyholders nationwide who own policies with New York-based mutual insurers, would be at risk of losing \$28 billion in equity, or an average of \$1,466 each, under H.R. 10. See chart entitled "New York Mutual Insurers Listed by Total Participating Policyholder Equity" (Tab A) for more details.

"Since the New York legislature rejected the anti-consumer mutual holding company conversion method after considerable debate, these 17.5 million policyholder-owners across the country are now protected," said Adkins. "But if the current pro-

industry provisions in H.R. 10 become law, these policyholders alone could be stripped of \$28 billion," he said. "Members of Congress must be unaware of the scope of this looming catastrophe, or they would reject these amendments which serve the interests of mutual executives (who stand to get rich on stock options) at the expense of so many of their voting constituents," said Adkins. "If enacted, the mutual redomestication provisions of H.R. 10 will also precipitate a race to the bottom as states compete for insurers' tax dollars by offering the most anti-consumer and pro-industry legislation they can devise to encourage mutuals to move to their state," he said. It would also effectively overrule the legislatures that have not enacted the pro-industry laws.

The Center's analyses also quantify the possible adverse financial impact of mutual holding company ("MHC") conversions on policyholders on a state-by-state basis. For example, there are 1.7 million policyholders in New Jersey, 5.9 million policyholders in New York, 637,000 million in Georgia, 542,000 million in Indiana, and 643,000 policyholders in Virginia who own policies with mutuals based in the minority of states that have adopted mutual holding company laws. If these mutuals were to convert to MHCs, New Jersey policyholders would lose \$3.7 billion, New York policyholders \$12.4 billion, Georgia policyholders \$1.2 billion, Indiana policyholders \$962 million and Virginia policyholders \$1.9 billion. None of these states have MHC laws.

"While H.R. 10 will directly affect those policyholders in the 27 states that do not allow the controversial-type conversions, passage of the federal legislation could give a green light to hundreds of mutuals in the 23 states with such laws that Congress has turned its back on millions of their constituents," said Brendan Bridgeland, Policy Director for the Center. "That could open the flood-gates for mutual executives hoping to convert to stock so they can themselves receive stock options, without having to compensate their policyholder-owners," he said.

The analyses are based on the 1997 financial data reported by the nation's mutual insurance companies to state insurance regulators. The analyses are part of a larger study designed to quantify what the financial impact would be on mutual policyholders nationally if their mutuals converted to stock under the controversial MHC laws which have been enacted in just 23 of the 50 states.

The analysis assumes that each policyholder owns one policy, thus making the average loss per policyholder a conservative estimate. The number of policyholders affected would decrease if it were assumed that many policyholders (e.g., 10%) own more than one policy, and the average loss in equity per policyholders would increase proportionally. However, the estimated economic impact in a state would remain the same.

The federal bill, H.R. 10, now represents the greatest potential disaster to consumers, particularly in the 27 states that have not enacted MHC laws. As noted above, the starkest example can be seen in New York State. (See accompanying chart titled "New York Mutual Insurers Listed by Total Participating Policyholder Equity.") New York-based mutual insurance giants such as Metropolitan Life, New York Life and dozens of others are currently prohibited from converting to mutual holding companies because the New York Legislature rejected the anti-consumer mutual holding company bill in 1997. If the redomestication provision in H.R. 10 is included in the final law, thus permitting these insurers to move to another state that permits such reorganizations, and they do so convert, policyholders nationally could lose over \$28 billion, or almost \$1,500 each, in policyholder equity. On top of it all, over 60% of the loss will be felt by policyholders in states that have not passed mutual holding company legislation.

Besides the New York chart mentioned above, two basic types of charts show the effects of mutual holding company laws: 1) charts that demonstrate potential losses of policyholder equity for a particular state, and 2) charts that show actual or potential loss of policyholder equity on a national level.

Below are some of the findings, followed by a description of charts containing the underlying data.

1. What is going to happen to the policyholders in a particular state if most of the major mutual insurers convert to a mutual holding company structure?

The analysis shows, for example, what would happen to the average participating policyholder (assuming each policyholder has one policy) in the following states if all the major mutuals converted to a mutual holding company structure:

- ☞ New York's 5.9 million policyholders would lose a total of \$12.4 billion, with the average policyholder losing over \$1,800.
- ☞ New Jersey's 1.7 million policyholders would lose a total of \$3.7 billion, with the average policyholder losing about \$1,600.
- ☞ Massachusetts's 2 million policyholders would lose a total of \$5.6 billion, with the average policyholder losing over \$1,600.
- ☞ Minnesota's 613,000 policyholders would lose a total of \$2 billion, with the average policyholder losing over \$1,800.
- ☞ Michigan's 1.1 million policyholders would lose a total of \$2.25 billion, with the average policyholder losing over \$1,800.
- ☞ Virginia's 643,000 policyholders would lose a total of \$1.9 billion, with the average policyholder losing over \$1,900.
- ☞ Georgia's 637,000 policyholders would lose a total of \$1.2 billion, with the average policyholder losing about \$1,900.
- ☞ Indiana's 542,000 policyholders would lose a total of \$962 million, with the average policyholder losing about \$1,800.

For details and further analysis, including data on a company by company basis, find the "Impact of MHC Laws on States" chart (Tab B) for a particular state.

2. What is the total amount of policyholder equity already at risk nationally?

The analysis demonstrates the following actual and potential effects of mutual holding company conversions nationally: 1) even in states that do not have mutual holding company laws, policyholders can lose thousands of dollars each, and 2) even though only the regulators of an insurer's home state have to approve a

mutual holding company conversion, most of the loss from that conversion will likely be felt outside the insurer's home state. For example:

- ☞ If all mutual insurers studied converted to a mutual holding company structure, 35.5 million participating policyholders nationally would lose \$94.7 billion, with the average participating policyholder losing about \$1,700.
- ☞ Most of the loss, or 52%, would be suffered by participating policyholders in states that do not have mutual holding company legislation.
- ☞ On average, the mutual insurers studied wrote about 79% of their business outside of their home state. For example, Northwestern Mutual, whose 3.8 million policyholders own about \$7.4 billion in equity, does 94% of its business outside its home state of Wisconsin. Mutual of Omaha, whose 55,000 policyholders own about \$1.5 billion in equity (for a whopping \$27,000 each), does 98% of its business outside its home state of Nebraska.

For details and further analysis, including data on a company by company information, find the "Mutual Insurers Listed by Total Participating Policyholder Equity" chart (Tab C).

3. **How much have policyholders already lost to mutual holding company conversions?**

The analysis also shows the damage already done by some of the largest mutual holding company conversions. For example:

- ☞ An estimated 3.2 million participating policyholders have already lost \$10.5 billion in equity.
- ☞ The average participating policyholder in these conversions would have received about \$3,200 (more than twice the national average) if their insurer had chosen to demutualize – a fact never disclosed by these insurers to their voting policyholders.

For details and further analysis, including data on a company by company basis, find the chart titled "Mutual Insurance Holding Company Subsidiaries Listed by Total Participating Policyholder Equity" (Tab D). This chart, which again includes a boxed summary of important data,

Other charts show how much, on the other hand, policyholders have received (or will receive) in exchange for their membership interests in traditional mutual-to-stock company conversions (that is, a "demutualization"), and how much is at risk nationally for policyholders of mutual life, health, and property/casualty insurers, respectively and in the aggregate (Tab E). For example:

- ☞ If Metropolitan Life demutualizes as currently planned, its 10.1 million participating policyholders will receive close to \$13 billion, with the average participating policyholder receiving about \$1,300.
- ☞ Participating policyholders nationwide of mutual life insurers have \$59.3 billion in equity at risk, with 55% of the potential damage potentially occurring in states without mutual holding company laws.

Note that while New York-based Metropolitan Life currently has plans to demutualize, there can be no guarantee what will happen if H.R. 10 passes.

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The Center for Insurance Research, Inc., established in 1991, is a non-profit, tax-exempt 501(c)(3) organization that conducts studies and advocates on behalf of the public interest in insurance matters in Massachusetts and nationwide.

A QUICK GLANCE AT THE H.R. 10 IMPACT ON MUTUAL POLICYHOLDERS

For a stark look at the looming disaster if H.R. 10 becomes law, take the example of New York State. The New York charts enclosed show two different views of the potential effect.

The first chart, at Tab A, titled "New York Mutual Insurers Listed by Total Participating Policyholder Equity," shows what would happen if New York mutuals – currently prohibited from converting to mutual holding companies because New York rejected the mutual holding company bill – took advantage of H.R. 10, redomiciled, and converted under some other state's mutual holding company law. The chart shows that policyholders nationally could lose over \$28 billion in policyholder equity and the average policyholder could lose almost \$1,500. On top of it all, over 60% of the loss will be felt by policyholders in states that have not passed mutual holding company legislation.

The second chart, at Tab B, titled "Impact of MHC Laws on States: Estimated Participating Policyholder Equity at Risk" (in New York) shows what would happen to mutual policyholders whose mutuals are based in states with mutual holding company laws if they converted. The boxed summary at the top shows, for example, that the 5.9 million participating policyholders in New York would lose \$12.4 billion, or an average of almost \$1,600 each (assuming each policyholder has one policy), among other things. The main body of the chart presents similar information on a company by company basis: for example, if Northwestern, a Wisconsin insurer, converted to a mutual holding company structure, Northwestern's 289,000 participating policyholders in New York would lose a total of \$565 million in equity, or on average almost \$2,000 each.

The Honorable Henry J. Hyde
Chairman
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

We understand that the House Judiciary Committee will mark up H.R. 833, the Bankruptcy Reform Act of 1999, on March 25, 1999. This letter provides the position of the Administration on consumer bankruptcy reform, and outlining the Justice Department's views on H.R. 833 as a whole.

General Administration Perspectives

The President supports responsible bankruptcy reform that is balanced, would reduce abuses of the bankruptcy system, and would require debtors and creditors alike to act responsibly. The President remains hopeful that bipartisan consultation and compromise will result in legislation that he can enthusiastically sign this year.

Last year the Administration expressed its strong opposition to the House-passed version of H.R. 3150. We encouraged passage of the Senate bill "as an important step toward balanced bankruptcy reform," but noted that the Administration would support its enactment only if the essential reforms incorporated by the Senate managers' amendment [were] preserved and strengthened and the unbalanced and arbitrary elements of the current House bill [were] omitted. Although we thought that the Senate bill could be further improved, we believed that the extraordinary bipartisan support for the Senate bill was an endorsement of balance and moderation.

During this year's debate, the Administration will continue to encourage Congress to find an appropriate balance. Among the issues that must be addressed are:

- **Access to Chapter 7:** Any ~~means test~~ imposed should deny access to Chapter 7 only to those who genuinely have the capacity to repay a portion of their debts successfully under a Chapter 13 repayment plan. Thus, debtors affected by a means test must be given a meaningful opportunity to have their specific circumstances considered by bankruptcy courts with discretion to determine whether they genuinely have the capacity to repay a portion of their debts. In addition, the time periods and thresholds used in any means test should be set to ensure that only those with a strong likelihood of success are affected.

- **Nondischargeable Debts:**

It is generally inappropriate to make post-bankruptcy credit card debt a new category of nondischargeable debt. The Bankruptcy Code makes debts nondischargeable only where there is an overriding payments, educational loans, tax obligations, or debts incurred by fraud. We remain skeptical that the current protections against fraud and debt run-up prior to bankruptcy are ineffective and that the additional debts made nondischargeable by this bill meet the standard of an overriding public purpose. If categories of nondischargeable debt are to be created, they should be narrowly tailored and limited to situations where the debtor is clearly abusing the system. That is, such as when the debtor: (1) incurred the debt to pay nondischargeable debt with an intent to avoid the debt in bankruptcy; and/or (2) incurred the debt on the eve of bankruptcy for goods and services that are not reasonably acquired to support the debtor's household.

- **Coercive Creditor Practices:** Particularly if we are to provide new opportunities for creditors to challenge debtors' use of the bankruptcy system under the 707(b) abuse test, it is imperative that we adequately limit prevalent abusive creditor practices such as coercive reaffirmations and violations of the automatic stay. While last year's Senate bill initially took laudable steps in this direction, the Conference Report rolled back existing consumer protections by denying consumers an effective means for remedying the harm from such practices and eliminating the current authorization for penalties for intentional violations of debtor rights.
- **Consumer Information and Protection:** The challenge posed by the unprecedented level of bankruptcy filings requires us to ask greater responsibility of debtors and creditors both. Credit card companies must give consumers more and better information so that they can understand and better manage their debts.

- **Homestead Exemptions:** At the same time that we are creating a system that will deny certain moderate-income Americans access to the traditional ~~fresh~~ start, we should also close the loopholes that allow the wealthy to shield hundreds of thousands of dollars of wealth from their creditors.

Justice Department Comments

TITLE I: CONSUMER BANKRUPTCY PROVISIONS

SUBTITLE A: NEEDS BASED BANKRUPTCY

Section 102. Dismissal or Conversion.

Section 102 of H.R. 833 amends section 707(b) of the Bankruptcy Code (the ~~Code~~). Under this amendment, a chapter 7 case filed by an individual with primarily consumer debts may be dismissed for abuse upon the motion of any party in interest, with certain limitations. Abuse is presumed when the debtor is able to repay at least 25 percent of non-priority unsecured debts or \$5000 over 60 months, applying IRS expense guidelines. The debtor may rebut the presumption of abuse by demonstrating extraordinary circumstances that require additional expenses or an adjustment of current monthly income. In deciding whether a case is abusive, the court must also consider whether the case was filed in bad faith whether the ~~totality~~ of the circumstances ~~demonstrates~~ abuse.

The Department supports strengthening the provisions of section 707 to ensure that debtors do not obtain a chapter 7 discharge. However, the proposed amendments raise a number of concerns, and for these reasons, we oppose section 102.

First, we are concerned that the ~~thresholds~~ are too low, and will have the effect of denying some debtors Chapter 7 relief who in fact have no significant ability to repay their debts. In addition, we believe that these thresholds unnecessarily saddle the bankruptcy system with extra costs, such as reviewing the income and expenses of low income debtors who are not able to repay their debts. We believe that changes should be made to minimize the costs to the bankruptcy system. And, this section does not make clear whether the ability-to-repay standards apply only to an individual debtor, or also to joint debtors.

Second, the use of the Internal Revenue Standards for allowable expenses is inappropriate because those standards were not intended for these purposes. The IRS standards were meant to provide guidelines for determining appropriate expenses. Last

year during its consideration of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206, Congress criticized the inflexible application of those guidelines and directed the IRS to also consider the taxpayer's facts and circumstances. The Joint Committee on Taxation explained the attitude of Congress regarding the guidelines in the following terms:

The Act requires the IRS to develop and publish schedules of national and local allowances that will provide taxpayers entering into an offer-in-compromise with adequate means to provide for basic living expenses. The IRS is also required to consider the facts and circumstances of a particular taxpayer's case in determining whether the national and local schedules are adequate for that particular taxpayer. If the facts indicate that use of scheduled allowances would be inadequate under the circumstances, the taxpayer is not limited by the national or local allowances.

See General Explanation of Tax Legislation Enacted in 1998 at 107 (1998).

Third, the multiple hurdles for rebutting the presumption of abuse -- ~~only~~ if the debtor can demonstrate ~~extraordinary~~ circumstances ~~that~~ make additional expenses or adjustments of income ~~necessary~~ and reasonable -- are conflicting and so strict as to effectively preclude the debtor from proving the existence of reasonable expenses that are not included within the IRS standards. We believe that the words ~~only~~, ~~extraordinary~~ and ~~necessary~~ should be deleted from proposed section 707(b)(2)(B). The debtor still would be required to prove to the court that additional expenses are both warranted and reasonable.

Fourth, the procedures set forth in Section 102 would impose a substantial burden on the courts and the trustees. As a general matter, chapter 7 cases flow through the bankruptcy system fairly quickly. Any delays that are built in (including the trustees' statement, the extension of time to file paperwork, etc...) will slow that process accordingly. More specifically, section 102(b)(2) of the H.R. 8331 amends 11 U.S.C. 704 to expand the duties of a chapter 7 trustee to require the trustee to file a statement with the court 10 days before the 341 meeting as to whether debtor's case should be presumed to be an abuse under the means-test formulation. The court must then notice the statement to all creditors within 5 days. If the debtor makes more than the highest national median family income for a family of equal or lesser size, the trustee *must* file a motion to dismiss within 30 days or file a statement of what a motion would not be appropriate. Since the section 341 meeting occurs within 20-40 days of filing, Fed. R. Bankr. P. 2003(a), the trustee's

statement must be filed within 10 to 30 days after filing depending on when the 341 meeting is. This means the trustee must make the determination before she even questions the debtor at the 341 meeting or before the documents are even filed which is very impractical. See Section 604 of the bill which appears to give debtors a 45 day grace period to file the requisite documents, while under current law, 11 U.S.C. 707(a)(3) debtors have only 15 days to file the documents required by 11 U.S.C. 521(1). It is not clear how the trustee can possibly do this assessment with any degree of due diligence in the time required. These problems threaten to significantly clog the formal bankruptcy processes. We stand ready to work with you to craft proposals that minimize the costs to the bankruptcy system.

Fifth, we do not think it appropriate for Section 102 to impose a higher duty on debtor's counsel than that set forth in Rule 9011. We believe that the standards in Rule 9011 are appropriate and we are concerned that the formulation set forth in Section 102 adds unnecessary complexity and confusion to the Bankruptcy Code.

Sixth, we do not believe it is appropriate to remove the risk of sanctions from all creditors who bring unjustified Rule 707(b) motions just because those creditors' claims may be less than \$1000. If the goal is to encourage small business creditors to bring appropriate Rule 707(b) motions, then the legislation should be drafted more narrowly to address those entities but exclude large creditors with many small claims. Otherwise the bill will serve to protect large creditors with sub-\$1000 claims who, with their size and efficiencies of scale, do not need this protection and who could use this protection to coerce debtors to reaffirm debts.

Seventh, section 102 also amends section 704 to require the trustee to file a statement with the court 10 days before the meeting of creditors, stating whether the debtor's case should be presumed abusive based upon ability to repay, and file a motion to dismiss within 30 days of filing the statement. It is impractical to require the trustee to file such a statement before the meeting of creditors especially when section 604 of this bill gives debtors up to 45 days to complete their schedules, and liberal amendments to schedules are permitted. The necessity of such a statement is also doubtful insofar as section 102 requires the debtor to file a statement containing the necessary ability to repay calculations.

Section 103. Notice of Alternatives.

Section 103 of H.R. 833 would, in part, amend section 342 of the Code to ensure that consumer debtors receive information about debt counseling services and their options before filing

bankruptcy. The form of the notice would be prescribed by the United States Trustee for the district and would contain a brief description of the bankruptcy chapters, the benefits and costs of each chapter and services available from a credit counseling service approved by the United States Trustee for that district. We support the concept of consumer education that underlies section 103.

Section 104. Debtor Financial Management Test Program

Section 104 of H.R. 833 would require the Executive Office for United States Trustees, in consultation with experts, to develop a financial management training curriculum for debtor education in three pilot districts for a one year period. The materials would also be made available to individual debtors on request. The courts in the pilot districts would be authorized to make attendance at the debtor education program a condition of discharge. The Director of the Executive Office would also be required to evaluate the effectiveness of the pilots and existing debtor education programs and to submit a report of his findings to Congress.

Provided that adequate resources are appropriated for the test program, the Department supports this as the best way to refine effective debtor education programs before they are extended nationwide. However, H.R. 833 creates confusion as to whether debtor education is to be a test or a permanent program. Section 302(b) and (c) of H.R. 833 condition the debtor's discharge upon completion of ~~an~~ instructional course concerning personal financial management described in section 111. ~~This~~ language suggests a permanent program. Moreover, section 111 does not address such courses. We believe these provisions may have been carried over inadvertently from an earlier draft, and suggest they be deleted.

SUBTITLE B: CONSUMER BANKRUPTCY PROTECTIONS

Sections 105 to 108. Disclosures (Debt relief agencies)

Sections 105 to 108 of H.R. 833 deal with debt relief agencies. Section 105 defines covered debt relief agencies. Section 106 would require such agencies to provide the person they are assisting in filing bankruptcy with written notice of the requirements that all bankruptcy schedules must be accurate, that the information is subject to audit, and that the failure to provide accurate information may result in dismissal of the bankruptcy case, sanctions or criminal prosecution. Debt relief agencies would be required to provide a separate notice advising the assisted person that the debt relief agency is required, *inter alia*, to enter a written contract. Finally, debt relief

agencies would be required to inform assisted individuals on matters such as how to determine what property is exempt and how to value exempt property at replacement value.

The Department opposes section 106, as currently drafted, because it would undercut the consumer protections currently contained in section 110 of the Code and state law, which impose penalties on persons who negligently or fraudulently prepare bankruptcy petitions. Because debt relief agencies would be defined to include petition-preparers and other non-attorneys, the advice required to be given by a counseling agency could constitute the unauthorized practice of law. To avoid this problem, section 106 of H.R. 833 should be amended to exclude non-attorneys from the provisions of new section 526(c), and to add to the form notice outlined in section 526(b) a statement that the debt relief counseling agency employee cannot provide legal advice if he or she is not an attorney.

Section 107 of H.R. 833 would provide the assisted person certain substantive rights when using a debt relief agency, including the right to a written contract that fully discloses all services and all charges. We do not oppose this concept, but believe that the standard of liability in the provisions should be changed. Section 107(b)(2) provides that a debt relief agency shall not make any statement . . . which is untrue and misleading or which upon the exercise of reasonable care, should be known by the debt relief agency to be untrue or misleading. (emphasis added). The underlined disjunctive ~~or~~ would impose strict liability upon a debt relief agency by imposing liability if the statement is untrue and misleading, even if the agency had no reason to know of the untruth or misleading nature of the statement. The Department suggests replacing the underlined ~~or~~ with ~~and~~ to establish a more appropriate standard of liability.

Finally, section 108 of H.R. 833 would provide penalties and other remedies for the failure of a debt relief agency to comply with the requirements of section 106 and 107, or for providing bankruptcy assistance in a case which is dismissed or converted for a failure to file bankruptcy papers. Section 108 should be clarified to allow a debtor, as well as the trustee, to bring an action for a violation and to clarify that the remedies are in addition to any remedies provided in section 110 of the Code.

Section 110. Discouraging Abusive Reaffirmation Practices

Section 110 addresses a problem of great significance; unscrupulous creditor practices designed to coerce debtors into reaffirming debts, particularly unsecured debts, even when doing so clearly is not in the best interests of the debtor. Currently, section 524(c) of the Code imposes a number of limitations on reaffirmation agreements, but the extant evidence

suggests that abusive reaffirmation practices continue. The National Bankruptcy Review Commission recommended even stricter rules regarding reaffirmation of secured debt, and the complete elimination of reaffirmations of unsecured debt.

Section 110 attempts to address this problem by requiring that creditors who seek reaffirmation of wholly unsecured consumer debt provide a disclosure that the debtor is entitled to a hearing. The debtor also can waive his right to a hearing if represented by counsel.

We believe that a far more effective approach would (1) require disclosure of the component amounts of any debt to be reaffirmed; (2) require court review for reaffirmations of relatively small amounts where the creditor claims a purchase money security interest; (3) prohibit the addition of costs and attorneys fees on at least these smaller claims. We would be happy to work with the Committee to develop stronger, more effective rules to discourage abusive reaffirmation practices.

Section 111. Promoting Alternative Dispute Resolution.

Section 111 would create an incentive for the parties to use alternative dispute resolution prior to the filing of a petition. We wholeheartedly support efforts to encourage the use of alternative dispute resolution in this context, but believe Section 111 is too limited because it applies only in limited circumstances. Under this section, alternative dispute resolution would be encouraged by imposing a penalty in cases where a creditor who unreasonably refused to negotiate an alternative repayment schedule proposed by an approved credit counseling agency. The penalty applies only if the debtor's offer was made at least 60 days prior to the filing of the petition; and the offer provided a specified percentage payment (60% over a specified time). A more effective approach would be to encourage parties to use any appropriate neutral, and give them leeway to determine when it is appropriate to settle and for what amount. We would be happy to work with the Committee to draft a more effective rule.

Sections 116 to 117. Effect of Discharge; Automatic Stay.

Section 116 addresses several issues. First, it states that the willful failure of a creditor to credit payments received under a confirmed plan shall constitute a violation of a discharge injunction under subsection 524(a)(2) of the Code. We support this provision but suggest two modifications. First, the court should be given discretionary, rather than mandatory, authority to grant sanctions, so as to allow the court to consider situations where the creditor had a good faith basis to believe the debt was not discharged. Second, we suggest the

provision be amended to require the debtor first to exhaust efforts to obtain administrative relief where applicable.

Next, section 116 bars debtors who are injured by the failure of a creditor to comply with the law regarding reaffirmation agreements or the crediting of plan payments from bringing a class action suit. In addition, the provision would limit recovery to actual damages or \$1000, whichever is greater, plus costs and attorneys' fees. Recent litigation has demonstrated that these kinds of violations do in fact occur, at times, on a class-wide basis in circumstances where individual damages may be too small to encourage a debtor to bring a claim. Moreover, we believe that treble damages would be a more effective incentive to debtors to bring these claims. Accordingly, we strongly oppose this provision.

Section 117 bars class actions for violations of the automatic stay, and limits debtor recover to actual damages and reasonable costs, including attorneys fees. Once again, we strongly oppose the limitation on class actions, and support a treble damages provision as a more effective incentive to obtain compliance with the provisions of the automatic stay rules.

Section 119. Discouraging Bad Faith Repeat Filings.

In cases of refiling within a year, section 119 would provide a 30-day limit on the application of the automatic stay of section 362 of the Code. This section would not apply if, prior to termination and upon request of a party-in-interest, the court provides notice and a hearing to affected parties regarding the potential extension of the stay. Serial filings are a serious problem in many jurisdictions and, accordingly, we endorse the adoption of firm measures to address this issue. Repeat filings -- whether to obtain multiple discharges or to hold creditors at bay temporarily -- should not be encouraged or abided. This provision would provide a welcome limitation to abuse of the automatic stay provision of the Code by serial filers who have no hope or intention of ever being granted a discharge in bankruptcy.

Section 123. Giving Secured Creditors Fair Treatment In Chapter 13.

Section 123 would amend section 1325(a)(5)(B)(i) of the Bankruptcy Code to protect the lien of a secured creditor from release by a chapter 13 plan if the debtor fails to complete the plan. This provision would resolve an issue on which the bankruptcy courts are split. The issue arises when the debtor confirms a chapter 13 plan that reduces a creditor's lien to the current value of the collateral (so-called "lien stripping") and then, after completing the payments due on the secured portion of

the claim, but before the plan is completed, the debtor seeks to discharge the lien. Some courts hold that the collateral does not vest in the debtor until the entire plan is completed. See, e.g., In re Pruitt, 203 B.R. 134 (Bankr. N.D. Ind. 1996); In re Schieirl, 186 B.R. 498 (Bankr. D. Minn. 1995). Other courts have held that, upon payment of the secured portion of the creditor's claim, the collateral is released. See, e.g., In re Lee, 156 B.R. 628 (Bankr. D. Minn.), aff'd, 162 B.R. 217 (D. Minn. 1993); In re Nicewonger, 192 B.R. 886 (Bankr. N.D. Ohio 1996).

We support the limitations on lien discharge contained in section 123. A key advantage that chapter 13 offers debtors over chapter 7 is that a larger universe of property is subject to lien "strip down." Furthermore, in a chapter 13 plan, the debtor can redeem collateral with payment over time from future income. These advantages are often the debtor's chief reason for undertaking a chapter 13 plan. But because debtors may allocate their plan payments preferentially to pay secured indebtedness sooner than unsecured debt, the result can be a disincentive for debtors to finish their plans after paying enough to redeem the collateral. Debtors should not be permitted to obtain the benefits of chapter 13 without bearing its burdens.

Section 124. Restraining Abusive Purchases on Secured Credit.

Section 124 amends Section 506 of the Code in individual cases by barring the stripping of liens for personal property acquired by the debtor within 5 years of filing the bankruptcy petition. Currently, the debtor's power to strip liens in plans under chapters 11, 12 and 13 to the value of the collateral is not limited by the time lapsed since purchase.

Expanding the ~~look back~~ to 5 years changes its character, and creates a significant limitation on the attractiveness of reorganizations for debtors, especially under chapter 13. A key advantage of chapter 13 for debtors is the expanded ability it affords to retain property subject to liens. Not only can debtors reduce the payments down to the value of the collateral, but they can also pay the liens off over time from the plan payments. Many courts allow debtors to ~~front load~~ the payments for their secured debt; in such cases, debtors who retire their secured debts under their plans may have no incentive to finish their plans, and may default without making substantial payments to their unsecured creditors. (The latter result is addressed by section 123, which precludes a strip down where the debtor fails to complete the plan; we support this provision.) This provision therefore may reduce substantially the number of debtors who voluntarily file chapter 13. This change benefits lenders who take personal property, such as cars, as collateral. The lack of strip down means that debtors must devote a greater percentage of their limited assets to secured creditors.

Although this modification may generally benefit the federal government, we believe a more balanced approach would be to return to the 180 day look back that was considered in the last year's legislative proposals.

Section 126. Exemptions.

Section 126 would amend section 522(b)(2)(A) of the Code to permit the use of state exemptions only if the debtor has been domiciled in the respective state for at least two years before filing. As written, this amendment could deny a debtor who has not resided in a state for at least two years, but is otherwise a resident of that state, the use of any state's exemption because many states prohibit the use of federal exemption law under so-called ~~opt out~~ laws. To prevent this situation from resulting in the debtor being unable to claim any homestead, the opt-out language of section 522 should also be modified, or this provision should be amended to permit the use of a state's exemption law where the debtor domicile has been located for the last two years, or for a longer portion of the last two years than in any other place.

Moreover, we urge that the homestead exemption be limited uniformly to \$100,000.

Section 129. Discharge under Chapter 13.

Section 129 governs the scope of discharge in Chapter 13 cases. Section 129 would limit the dischargeability of certain kinds of debt that cannot be discharged under section 523 of the code. We support this limitation. However, section 129 omits section 523(a)(3)(A) of the Code from its list of non-dischargeable debt, while it includes section 523(a)(3)(B). We see no basis for this bifurcation and suggest that entire section 523(a)(3) be included. Both subsections deal with a debtor's failure to schedule known debts. Subsection A deals with the unnotified creditor's ability to file a proof of claim. Subsection B deals with the unnotified creditor's ability to object to discharge on various grounds. As a matter of due process, the claims of such creditors who had no opportunity to participate in the bankruptcy should not be discharged.

Section 135. Limitations on Luxury Goods.

Section 135 would amend Section 523(a)(2)(C) of the Code to change the non-dischargeability rules for certain so-called luxury goods. First, it defines ~~luxury goods or services~~ so as to exclude those ~~reasonably necessary~~ for the support or maintenance of the debtor or a dependent of the debtor. ~~Reasonably necessary~~ is internally inconsistent. We prefer the formulation ~~reasonably acquired~~. Moreover, by including

~~necessary~~ the burden inappropriately shifts to the debtor to demonstrate that they ~~needed~~ the items expended. Second, it would establish a cap on dischargeable luxury goods or services of \$250, or cash advances of \$250, incurred within 90 days of filing the petition. We oppose the limitation. This would be a substantial change from the current law, which sets forth limits of \$1075 during the preceding 60 day period. Moreover, it is important to bear in mind that cash advances are not always obtained for frivolous expenses; debtors sometimes use cash advances to buy absolute necessities such as groceries.

Sections 141 to 147. Domestic Support Obligation.

Sections 141 defines domestic support obligations, and Section 142 establishes domestic support obligation as the first priority. We generally support this recognition of the critical societal importance of ensuring that domestic support obligations are not unduly reduced as a result of a debtor's bankruptcy. Without payments from domestic support obligations, the recipients of those payments may become destitute; it is therefore appropriate to give them a high priority. However, if an appropriate mechanism for funding the administrative costs of bankruptcy is not provided, too many debtors will go unrepresented. We would like to work with the Committee to ensure that there are no unintended consequences of this priority for domestic support obligations.

Sections 143 to 147 establish other special rules in the domestic support obligation context. Sections 143 and 144 establish special rules regarding confirmation and discharge, and exceptions to the automatic stay, in cases involving domestic support obligations. Section 145 makes certain domestic support obligations non-dischargeable. We support these provisions for the reasons stated above.

Section 149. Nondischargeable Debts.

Section 149 amends Section 523(a) of the Code in two ways. First, it would make non-dischargeable any debt that was incurred to pay an otherwise non-dischargeable debt with the intent to discharge the newly acquired debt. We support this change.

Second, Section 149 would also make non-dischargeable all debts incurred to pay non-dischargeable debts, without regard to intent, if incurred within 90 days of the petition. Proponents of this provision argue that one can presume that the debtor had the intent to avoid the debt in bankruptcy if they paid the nondischargeable debt with a dischargeable debt within 90 days of bankruptcy. Unfortunately, that is not a fair assumption. In the final months before filing a bankruptcy petition, a debtor may be struggling to retain a house or a car or feed a family.

Accordingly, he or she may put debts, such as student loans or taxes, on their credit card in a last attempt to meet their obligations. A review of the debtor's intent (for example, by looking at whether the debtor had yet consulted with bankruptcy counsel or whether the debtors had previously filed for bankruptcy and therefore was familiar with the rules) could uncover whether the payment in fact was abuse or not. By failing to weigh the intent of the debtor, this rule is overbroad and we strongly oppose its inclusion.

TITLE II: DISCOURAGING BANKRUPTCY ABUSE

Section 201. Reenactment of Chapter 12.

Section 201 reenacts Chapter 12 of the Code, pertaining to family farmers. We support this provision.

Section 202. Meetings of Creditors and Equity Security Holders.

Section 202 would amend section 341 of the Code to allow a court to direct the United States Trustee to dispense with the meeting of creditors in a case with a so-called ~~pre~~-packaged plan~~s~~, i.e., a reorganization plan worked out with creditors in advance of the filing of a Chapter 11 petition. We oppose this provision, which would significantly hinder the ability of creditors and the United States Trustee to examine a debtor's affairs under oath. Dispensing with the meeting could also increase the possibility of fraud and collusion by a debtor and its major creditors. We suggest this provision be deleted.

Section 203. Protection of Retirement Savings in Bankruptcy.

Section 203 exempts from the bankruptcy estate a qualified retirement fund, pursuant to certain standards set forth in this section. The effect of the amendments would be to enhance debtors' ability to prevent their interests in retirement accounts and funds, including Individual Retirement Accounts, from being used to satisfy their debts. The Administration has made encouraging adequate retirement savings a singular priority. We recognize that a fresh start is not meaningful if it requires the debtor to accept an impoverished retirement. However, a debtor should not be able to shield abundant resources from creditors, including other taxpayers, in the form of retirement savings. We look forward to working with the Committee to find the appropriate balance of these considerations.

Section 205. Executory Contracts and Unexpired Leases.

This section requires a debtor to assume an unexpired lease of non-residential real property within 180 days after filing the

petition or the lease is deemed rejected. We support this provision.

Section 206. Creditor and Equity Security Holders Committees.

Section 206 would amend section 1102 of the Code to allow a court to order changes in the membership of creditor and equity security holder committees. We strongly oppose this provision. Under section 1102 of the Code, United States Trustees are responsible for creating committees and appointing their members, while courts are called upon to resolve controversies arising from the committees. Section 206 would upset this balance and improperly involve the court in the administration of cases. This could create an appearance of favoritism if a court were called upon to resolve a controversy involving a committee it had constituted. The proposal could also result in increased cost and delay because early litigation over committee membership would inevitably decrease the ability of committees to participate at the early, critical stages of cases.

Nevertheless, the Department recognizes the desirability of revising section 1102 to ensure that effective and representative committees are appointed. Accordingly, we would suggest that this section be amended to require that any request to create or alter the membership of a committee be first directed to the United States Trustee and to permit the court, upon a request of a party in interest after an adverse decision by the United States Trustee, to make the requisite findings and order the United States Trustee to alter a committee. Such an amendment should also reaffirm the United States Trustee's authority to alter a committee. We would be happy to work with the Committee to draft language to accomplish this objective.

Section 209. Amendment to Section 330(a)

Section 209 would provide that in determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission based on the results achieved. We oppose this provision, which would create a singular incentive that could lead to abuses, or the perception of abuses, on the part of the trustee. We prefer the current multifactor analysis set forth in section 330(a)(3) of the Code.

Section 211. Preferences.

Section 211 would amend section 547(c) of the Code, which deals with preferential transfers of property to creditors after the filing of a bankruptcy petition. Section 207 would eliminate the ability of a trustee to avoid such a transfer in a case filed by a debtor whose debts are not primarily consumer debts, where

all the property that constitutes or is affected by the transfer is worth less than \$5,000.

We oppose this provision. Although this provision is apparently designed to protect the interests of smaller creditors, this section, without appropriate supervision, could lead to abuse and manipulation by debtors wishing to pay preferred creditors. For example, nothing in the provision would prohibit a debtor from breaking a larger payment into several smaller ones that each total less than \$5,000. If such preferential payments are not avoidable, the result could be a substantial diminution of the property available to pay priority claims.

Section 215 (second instance; listed in table of contents as section 216). Defaults Based on Nonmonetary Obligations.

Section 215 amends Section 365 of the Bankruptcy Code to allow the debtor to reinstate a lease of real property under which the debtor is in default if the default is not curable by paying money. In addition, the debtor is allowed the same power for an executory contract with the additional requirement that the court find that the ~~equities~~ excuse the debtor's usual obligation to cure. We oppose this provision for the reasons outlined below, and suggest that it be deleted.

Currently, Section 365 of the Code allows a debtor to resume performance of (or ~~assume~~) an executory contract or an unexpired lease, notwithstanding a default that would normally cost the debtor that right. To do so, the debtor must cure the default, compensate for the monetary loss, and assure adequately its future performance. Waiving the debtor's obligation to cure if the default is not curable by money ignores that many defaults going to the essence of the agreement are not curable by money. The non-debtor party should not be forced to perform where deprived of the full benefit of the bargain.

If section 215 is intended to address the problem that minor contractual breaches could otherwise be an obstacle to the debtor's power to assume, then this fear is misplaced. The common law has long distinguished between defaults that are minor (entitling only damages) and major (voiding the agreement). This proposal replaces, in the case of executory contracts, this familiar concept with the wholly novel notion of ~~equities~~. This gives no guidance to the judge or parties as to what factors should be weighed, and will therefore generate confusion and litigation.

TITLE III: GENERAL BUSINESS BANKRUPTCY PROVISIONS

Section 302. Miscellaneous Improvements.

Section 302 bars any debtor from filing a petition unless they have sought the assistance of credit counseling during the 90-day period prior to the filing of the petition. This provision does not apply in certain circumstances, such as filings due to exigent circumstances. Section 302 also requires debtors to attend educational courses prior to discharge in Chapter 7 and 13 cases. Section 302 requires the clerk of the court to maintain a list of credit counseling services and educational courses that have been approved by the U.S. Trustee.

We support the concept of credit counseling but question whether the utility of making it mandatory in chapter 13 where individuals will already be seeking to repay their creditors through a debt repayment plan. We also have concern about the requirement for United States Trustees to approve credit counseling agencies because it is a large, unstructured and regulated segment of the financial services industry. The list of approved agencies will serve as a Federal guide for would-be debtors, and we expect it will attract applicants of varying degrees of character and quality. It is important that the United States Trustees have sufficient tools and discretion to address the problems that will undoubtedly emerge. With one exception discussed below, the provision appears adequate, but sufficient resources must also be made available. We might also suggest, as an alternative, that a pilot program be created first in several districts to test the usefulness of credit counseling and its impact on filings.

One issue appears to have been overlooked and should be addressed. There is no automatic dismissal to enforce this provision if a debtor fails to file a certificate from a counselor pre or post-petition. Assuming the petition gets filed without a certificate, a party would then have to move to dismiss the case under 707(a), 1112(b), 1208(c), or 1307(c) based on the debtor's ineligibility.

Section 302(b)-(c) provides that a chapter 7 and a chapter 13 discharge are conditioned upon the debtor's completion of a post-filing instructional course. As noted above in comments to section 104, H.R. 833 appears to contain provisions for a pilot program, but this provision seems to assume a permanent program. There is a need to dispel the confusion. A pilot program is preferable.

Section 303. Extensions

Section 303 of H.R. 833 would amend section 302(d)(3) of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986 to eliminate the deadline for including

the judicial districts in the States of Alabama and North Carolina within the United States Trustee system. The Department strongly opposes the amendment because it would retain two separate systems of bankruptcy administration within the country and may be vulnerable to Constitutional attack under the Uniformity Clause.

When Congress made the United States Trustee Program (USTP) a nationwide program in 1986, the date the program was to commence varied in different judicial districts. Six federal judicial districts in the States of North Carolina and Alabama remain outside the program, and the date for the inclusion of these districts has been postponed until October 1, 2002 - sixteen years after the United States Trustee Program's nationwide expansion. Pub. L. No. 101-650, 317(a), (c), 104 Stat. 5115, 5116 (1992). In these six districts, Bankruptcy Administrators and court clerks employed by the judicial branch perform many of the functions that are performed by United States Trustees in USTP districts.

This arrangement may not comply with Article I's mandate to establish . . . uniform Laws on the subject of Bankruptcies throughout the United States. U.S. Const. Art I., §8., cl. 4. Supreme Court precedent on what uniformity means in this context is ambiguous. The leading case on the issue is Hanover National Bank v. Moyses, 186 U.S. 181 (1902), where the court rejected a challenge to the Bankruptcy Act of 1898, which recognized state exemptions instead of establishing a system of uniform federal exemptions. The opinion suggests that Congress can account for differences in state law in the bankruptcy laws without violating the requirement of uniformity. More recently, in Railway Labor Executives' Ass'n v. Gibbons, 455 U.S. 457 (1982), the Supreme Court struck down, as violative of Article I's uniformity requirement, a statute requiring employees of the Bankruptcy Rock Island and Pacific Railroad Co. estate to receive certain benefits if not rehired by other carriers. According to the Court, to survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of creditors. Gibbons, 455 U.S. at 473.

Given the lack of clarity on Article I's uniformity requirement and the doubts raised about the justification for maintaining both the USTP and Bankruptcy Administrator programs, additional challenges to the constitutionality of this dual system seem likely. See, e.g., St. Angelo v. Victoria Farms, Inc. 38 F.3d 1525, 1532 (1994); Joelson v. United States, 179 B.R. 857, 864 (N.D. Ohio 1995). In any event, maintaining a special system of bankruptcy administration for just six of the nation's 94 judicial districts is imprudent. No articulated policy justified maintaining the Bankruptcy Administrator program, and its continued existence not only threatens to inspire additional constitutional challenge, but is also contrary

to the fair, effective and uniform administration of the bankruptcy laws.

Finally, we note that section 303 is not referenced in the table of contents set out in section 1 of H.R. 833.

TITLE IV: SMALL BUSINESS BANKRUPTCY PROVISIONS

Sections 401 and 403. Flexible Rules for Disclosure Statement and Plan; Standard Form Disclosure Statements and Plans.

Section 401 would add a new section 1125(f) to the Code to allow the court to relax the plan confirmation procedures in small business bankruptcies. Specifically, for a small business case, the court would be empowered to: (i) waive the disclosure statement; (ii) use a form disclosure statement; (iii) allow plan solicitation based on a "conditionally approved" disclosure statement; or (iv) combine the confirmation and disclosure statement hearing. Section 403 would require the Judicial Conference to adopt "standard form" disclosure statements and plans of reorganization that balance the need for "reasonably complete information" with "economy and simplicity."

These provisions would remove procedural barriers to early confirmation and, to the extent they encourage quicker confirmations, are advantageous to debtors and creditors alike. Care will be needed lest the execution of these provisions lead to confirmations without adequate disclosure to creditors and other affected parties. We believe, however, that this risk is manageable. Accordingly, we support this provision.

Section 402. Definition of Small Business Debtor.

Section 402(a) defines the terms ~~small business debtor~~ and ~~small business case~~. The definition of small business case is apparently missing some words, but it appears that the definition excepts cases where a creditors' committee is formed and the court determines that it is ~~sufficiently active and representative to provide effective oversight of the debtor~~. This apparent exception defeats the purpose of the small business provisions to minimize the time a case remains in bankruptcy because it could lead to litigation over the exception. See section 407. The exception should be eliminated so that there is certainty at the commencement of the case whether it involves a small business or debtor.

Section 402(b), concerning penalties for violation of the discharge injunction, is unrelated to small business cases and is identical to section 116. It should be eliminated as duplicative.

Section 404. Uniform National Reporting Requirements.

Section 404 would add a new section 308 to the Code requiring a small business debtor to file periodic reports explaining: (i) its profitability; (ii) projected income and expenses; (iii) how prior projections compare with actuality; (iv) compliance with bankruptcy requirements; (v) whether taxes returns are timely filed; (vi) what taxes and other administrative claims are in default and when remedied; and (vii) "other matters" needed in the creditors' and the public's interest.

We support these disclosure requirements and the need for consistent financial reporting standards. By helping to identify faltering cases, financial reports prevent undue delay in the administration of chapter 11 cases. We further urge extending this section to all chapter 11 debtors, not just small business debtors.

Section 405. Uniform Reporting Rules and Forms.

Section 405 would require the Judicial Conference of the United States to propose for adoption amended Federal Rules of Bankruptcy Procedure and Official Bankruptcy Forms to be used by small business debtors to comply with the provisions added by Section 404 of the bill. We support this provision, with one exception: it should be amended to indicate that the Attorney General will promulgate the report forms. This is consistent with section 702 under which the Attorney General is to propose these forms and to collect data based on the information reported. It is essential that these two functions be merged under the same authority.

Section 408. Plan confirmation deadline.

Section 408 of H.R. 833 requires that small business chapter 11 cases be confirmed within 150 days of filing. This time period may be enlarged only if the debtor demonstrates by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable time.

The Department encourages the prompt disposition of cases but the 150-days cutoff may be too short. Currently only 4% of chapter 11 confirmations occur within 150 days of filing. Although substantial improvements in processing times have occurred during the last decade, the majority of confirmations still occur more than one year after filing. Additionally, over 60% of dismissals and conversions to chapter 7 occur more than 150 days after filing. Although section 408 would allow enlargement of this time period, our statistics show that only about 30% of chapter 11 cases result in confirmation. Furthermore, based solely on when a case is filed, there is no

age at which a chapter 11 cases has a 50% or better chance of being confirmed.

Section 410. Duties of the United States Trustee.

Section 410 would amend 28 U.S.C. § 586 to expand the United States Trustee's oversight of small business debtors. It would oblige the United States Trustee to interview the debtor before the first meeting of creditors, visit the debtor's premises, monitor the debtor's actions and, where grounds are found to do so, move to convert the case to a Chapter 7 or to dismiss the case altogether.

We support this provision, which would clarify and codify the United States Trustee's obligation to move hopeless cases out of chapter 11. This section reflects the current practice of the United States Trustees, except for the duty to visit the debtor's premises. We estimate that site visits would cost an additional \$10 million over 5 years.

Section 411. Scheduling Conferences.

Section 411 would amend section 105(d) of the Code to require the courts to hold status conferences ~~as~~ necessary. This provision would apply to all chapter 11 cases. To the extent it empowers the court to override requirements of the Code and Bankruptcy Rules, or to intrude into areas currently entrusted to the United States Trustee, it goes too far. While bankruptcy procedures should be somewhat flexible, we believe that it is important that bankruptcy judges not be permitted to vary, essentially at will, from statutory and rule requirements, potentially depriving creditors and other parties in interest of key procedural protections. We believe that the standard incorporated in section 411 does not adequately preserve these procedural protections, and we therefore oppose the provision. In addition, it would allow the courts to vary from the Code and the Bankruptcy Rules if "necessary to further the expeditious and economical resolution of the case".

Section 412. Serial Filer Provisions.

Section 412 would amend section 362 of the Bankruptcy Code to disable the automatic stay for a small business filing, where: (i) the debtor is already in bankruptcy; (ii) had a case dismissed or a plan confirmed within two years prior to filing; or (iii) acquired the assets of a debtor in a proceeding covered by (i) or (ii), unless the debtor shows that its filing resulted from causes unforeseeable during the prior case and that a non-liquidating plan may be confirmed within a reasonable time.

Serial filings are a serious problem in many jurisdictions and we endorse the adoption of firm measures to address this issue. Repeat filings -- whether to obtain multiple discharges or to hold creditors at bay temporarily -- should not be permitted. Accordingly, we support section 412 of the bill. However, we believe that applying this restriction only to small business debtors is too limited and that this provision instead should apply to all debtors in chapter 11.

Section 413. Expanded Grounds For Dismissal or Conversion and Appointment of Trustee.

Section 413 would amend section 1112 of the Code to require the conversion to chapter 7 or dismissal of any chapter 11 case where "cause" is shown. This requirement would not apply if the debtor could show that a plan may be confirmed within a reasonable time and, where the "cause" is a default, that the default is justified and will be cured promptly. "Cause" would be defined to include a variety of situations, including "gross mismanagement;" misuse of cash collateral; a violation of a court order; default of a filing or reporting requirement; the nonpayment of taxes or nonfiling of a return; and not filing timely a disclosure statement or plan or confirming a plan.

We support this provision. It is one of several in the bill designed to move cases that cannot be confirmed out of chapter 11. Defining "cause" using more objective standards would foster uniformity and enhance efficiency. Shifting the burden to the debtor to justify defaults and prove satisfactory progress when cause is shown appropriately conditions the debtor's enjoyment of the benefits of bankruptcy on responsible actions.

Section 415. Payment of Interest

Section 415 would amend section 362(d)(3) of the Bankruptcy Code to limit the automatic stay in a single asset real estate (SARE) case, where the debtor fails to file a plan or commence interest payments within 90 days of filing, to: (i) allow the payment to commence 30 days after the court determines that the debtor is a SARE; (ii) allow the debtor to make the interests payments from post-petition rents of the SARE; and (iii) specify the non-default contract rate as the interest rate.

We oppose this change. Under current section 362(d)(3) of the Code, creditors of a SARE debtor may have the automatic stay lifted if the debtor has not filed a "feasible" reorganization plan within 90 days of filing or has not commenced monthly payments to secured creditors. Giving the debtor 30 days to comply after the court rules that the debtor is subject to section 362(d)(3) is unwise. The exception to the automatic stay in section 362(d)(3) takes its force from the 90 days time limit.

That force is substantially diminished by relaxing that limit for debtors who claim, or who can find a pretext for claiming, that it does not apply. It is also unnecessary; the court currently can extend the 90 days for "cause."

Giving the debtor the "sole discretion" to override section 363(c)(2) and make interest payments out of post-petition rents is also ill-advised. First, the amendment does not require that the creditor receiving the rents be the same as the creditor whose rights are voided. Second, even if the creditor receiving the rents is being paid its own collateral, the amendment serves to limit that creditor's rights. Currently, this section works largely as a predicate to allow the secured creditor and the debtor to negotiate a consensual payment schedule. Giving the debtor the discretion to override the secured creditor's interests stands the purpose of the section on its head.

Finally, allowing the debtor to pay at the contract rate is inconsistent with paying a "stripped down" value in the case of an undersecured creditor. If the payment's principal is a function of market value, the interest rate should be calculated the same way. We oppose this change as well.

TITLE VI: STREAMLINING THE BANKRUPTCY SYSTEM

Section 601. Creditor Representation at First Meeting of Creditors.

Section 601 would amend section 341 of the Code to allow non-attorney consumer creditor representatives to attend and participate in chapter 7 and chapter 13 creditors' meetings notwithstanding federal, state or local non-bankruptcy law to the contrary. The Department supports this provision because it promotes the participation of creditors in the bankruptcy process. We strongly encourage further amendment to delete the phrase "holding a consumer debt" from the section to ensure the ability of all creditors, including non-lawyer representatives of governmental creditors, to participate in creditor meetings.

Section 602. Audit Procedures

Section 602 would amend 28 U.S.C. § 586 to require the Attorney General to establish procedures for auditing of a debtor's petition, schedules, statement of financial affairs and other similar information in all consumer chapter 7 and 13 cases. At least one out of every 250 of the consumer cases in each judicial district would be randomly chosen for audit, in addition to those cases where the debtor's income and expenses exceed the mean variance in the judicial district.

The Department supports the concept of debtor audits. The bankruptcy system is dependent upon the full and voluntary disclosure by debtors of accurate information regarding their assets, liabilities and financial affairs. A systematic program of random audits would serve to deter those who might otherwise be tempted to conceal assets and information from their creditors. We also believe assigning this responsibility to the Department makes sense given the central role of United States Trustees in ensuring the integrity of the bankruptcy system.

The Department, however, opposes section 602 in its current form because of its feasibility and cost. The proposal requires independent Certified Public Accountants (CPAs) to conduct "audits" in accordance with ~~the~~ generally accepted auditing standards, ~~a~~ a term of art within the accounting profession. It is questionable whether an audit conducted by an independent CPA and in accordance with these principles is feasible or desirable in most consumer cases given that a debtor's financial records are often nonexistent or in disarray.

Assuming that the practical problems associated with conducting an audit can be resolved, the provision as drafted would be costly. The Department has estimated that implementing the audit program contemplated by this section could cost from \$18.6 million to more than \$59 million over five years. This cost is in large part a function of the number audited and the use of independent CPAs. The cost of the audits could easily consume a significant portion of the total sum appropriated to fund the entire United States Trustee program in Fiscal Year 1998. Moreover, the bill provides no funding mechanism to cover these costs.

The use of an audit report is left similarly vague. Copies of the audit reports are to be filed with the Court, but it is uncertain if this would be merely for the purpose of providing a public repository for the report accessible to all parties in interest, or if it is intended that the Court would, *sua sponte*, initiate action based on the auditors' findings.

We recommend that the following changes be made to Section 602:

- ° Require the Attorney General to establish a system to audit consumer debtor cases on either a random or targeted basis, but without a minimal prescribed percentage;
- ° Eliminate the mandatory use of independent CPAs and generally accepted auditing standards;
- ° Eliminate the requirement of filing the audit reports with the court;

- ° Provide a civil sanction to ensure debtor's compliance with the audit and defer a section 727 discharge until the U.S. Trustee reports a satisfactory audit. instead of placing the burden on the U.S. Trustee to file a complaint to bar the debtor's discharge in the case of noncompliance; and
- ° Provide a source to fund the audits other than assessments upon the affected debtors.

Given the size of the audit program and its cost, the Department also urges the committee to consider a pilot program for audits that would allow the costs and benefits of various approaches to be considered. In addition, consideration should be given to limiting random audits to chapter 7 debtors.

Section 603. Giving Creditors Fair Notice in Chapter 7 and 13 Cases

Section 603 would amend the notice provisions of section 342 of the Bankruptcy Code to require, in an individual bankruptcy case, that notices to creditors include any account number and be sent to the address that a creditor has specified. It also would require that a matrix of addresses prescribed by creditors for notices in a district be established. Further, unless actual notice is sent to the specified addresses and received by a responsible person or department at the creditor, notice would be ineffective, the creditor could not be sanctioned for violating the automatic stay and turnover of property could not be enforced.

While this section has some technical difficulties, we strongly support the intent of this section to ensure that debtors know how to give effective notice and that the creditors, in fact, receive such notice. Indeed, we urge that this provision for fair notice apply to all bankruptcy chapters -- there is no reason to limit this provision only to chapter 7 and 13. We would be happy to work with the Committee to correct any technical problems.

Section 604. Dismissal for Failure to Timely File Schedules or Required Information.

Section 604 provides that in voluntary cases under chapters 7 or 13, a case shall automatically be dismissed if the debtor fails to file all required information within 45 after filing the petition. The Department does not oppose this provision, so long as dismissal is without prejudice, and we suggest an appropriate clarification.

Section 605: Adequate Time to Prepare for Hearing on Confirmation of the Plan.

Section 605 of H.R. 833, *inter alia*, would give a chapter 13 debtor up to 90 days after the order for relief to file a chapter 13 plan. Under current law, a debtor must file a plan within 15 days from entry of the order of relief. Fed. R. Bankr. P. 3015(b). The Department opposes this enlargement of time as contrary to the principles of expeditious case administration. Due to other provisions in H.R. 833 requiring the debtor to file certain information and documents with the petition, both the chapter 13 debtor and debtor's counsel should be well prepared to propose a plan within the current 15-day window.

Section 608. Elimination of Certain Fees Payable in Chapter 11 Bankruptcy Cases.

Section 608 of H.R. 833 would amend section 1930(a)(6) of title 28, United States Code, to except all debtors whose quarterly disbursements are less than \$300,000 from paying post-confirmation quarterly fees. The Department opposes this provision because it would eliminate one of the most effective tools to encourage the prompt administration and closing of chapter 11 cases. This section would also result in a revenue loss to the United States Trustee Program of at least \$9 million annually and would require a new source of funding to replace that loss, since the Program is a fully fee funded agency.

Section 609. Prompt Relief from Stay in Individual Cases.

Section 609 provides that, in any individual case under chapters 7, 11 or 13, the automatic stay shall terminate 60 days after so requested by a party unless the court makes a final decision, the parties agree to an extension, or the court finds good cause supporting an extension. We support this provision.

Section 610. Stopping Abusive Conversions From Chapter 13.

Section 610 would amend section 348(f)(1) of the Code to reverse the bifurcation of a secured creditor's claim into secured and unsecured portions accomplished through a chapter 13 plan, if the case is converted to chapter 7. This provision thus would limit the debtor's ability to release the lien in a chapter 7 case under section 722 of the Code.

For the same reasons that we support section 123, we also support this change. This provision addresses a different aspect of the same problem dealt with in section 123 above. Both provisions concern a debtor who confirms a chapter 13 plan that reduces a creditor's lien to the value of the collateral. Unlike section 123, however, section 610 deals with the situation where, after paying part of the secured portion of the claim, the debtor converts his unfinished 13 plan into chapter 7 liquidation. In

the chapter 7 case, the debtor then redeems the collateral by tendering the balance due on the "stripped down" lien after taking credit for the payments made under the chapter 13 plan. Unless this option is barred, debtors will have an incentive to take the benefits conferred by chapter 13, and then convert to a chapter 7 without finishing their chapter 13 plans.

TITLE VII: BANKRUPTCY DATA

Section 702. Uniform rules for the collection of bankruptcy data

Section 702 requires the Attorney General to issue rules prescribing uniform reporting forms for final and periodic reports. The Department supports this provision, but note two problems. It conflicts with section 405, which requires the Judicial Conference to create an official form for periodic reports in small business chapter 11 cases. Section 405 should be amended to reflect the role of the Attorney General in promulgating the form of these reports. We also question the provision in this section requiring the Attorney General to maintain final reports in one or more central locations. Currently, all final reports are filed with the courts, and section 702 provides for electronic access through the Internet. We would be happy to work with the committee to recommend appropriate changes to these provisions.

TITLE VIII: BANKRUPTCY TAX PROVISIONS

Section 801. Treatment of Certain Liens.

Section 801 deals with subordination of tax liens under section 724(b) of the Code, and is identical to section 2 of S. 1149, the Investment in Education Act, a bill passed by the Senate on October 30, 1997. Under the proposed changes, ad valorem property taxes would generally be protected from subordination. Reversing current law, expenses of a failed chapter 11 proceeding would not be given preferential treatment over tax liens, with a limited exception. Exhaustion of unencumbered assets would be required before tax liens could be subordinated, and expenses of preserving or disposing of secured property must be recovered from the property (reducing the expenses to which a tax lien would be subordinated).

We support this provision. The public fisc should not be required to subsidize failed chapter 11 cases by having tax liens subordinated in order to pay administrative expenses of insolvent reorganization proceedings. Moreover, in chapter 7 cases, other unencumbered assets should be used to satisfy administrative expenses and any expenses properly allocable to secured claims should be recovered from the property.

Section 802. Effective Notice to Government

Section 802 of would amend section 342 of the Code to improve notice to the entities most frequently participating in the bankruptcy process -- governmental units. It would require identification of the agency through which the debtor is indebted; disclosure of identifying information concerning the claim (such as taxpayer identification numbers and real estate parcel designations); and creation of a matrix of addresses of governmental units. In addition, it would give incentives to debtors to use the designated addresses.

We support these provisions. They are in accord with Recommendation 4.2.1 of the National Bankruptcy Review Commission, which urged redress of the current deficiencies in notifying governmental units. This provision would ensure reasonable identification of both the affected government agency and the debtor obligated on the debt. It would also create a mechanism for giving debtors accurate addresses to which notices should be sent. Finally, it would promote compliance with the mechanism by providing exceptions to bar dates and dischargeability when a debtor fails to comply with the prescribed mechanism. We suggest, however, that the reference point in subsection (c) be corrected from notice of the bankruptcy "case" to notice of "the matter or proceeding in respect to which the notice was provided."

Section 803. Notice of Request for a Determination of Taxes.

Section 803 would amend section 505(b) of the Code to provide that a request for prompt audit of a tax return should be sent to the office designated by the taxing authority. Thus, for example, a notice sent to the Secretary of the Treasury in Washington, rather than to the Special Procedures unit of the IRS District Director where the bankruptcy is pending, would not suffice. We support this proposal.

Section 804. Rate of Interest on Tax Claims.

Section 804 would enact as Section 511 of the Code a new provision relating to the interest rate on, or determining the present value, of a tax claim. Under current law, the court must generally determine the ~~market rate~~ under such circumstances. Section 511 would provide that if the holder of an unsecured prepetition tax claim is entitled to interest on such claim, the minimum rate of interest will be the Federal short-term rate rounded to the nearest full percent, determined under section 1274(d) of the Internal Revenue Code for the calendar month in which the plan is confirmed, plus three percentage points. The section 6621(a)(2) rate is also based on the Federal short-term rate, plus three percentage points, but is fixed on a quarterly

basis at the rate for the first month of a quarter rather than redetermined monthly. In the case of secured tax claims and administrative tax claims, the applicable nonbankruptcy rate would apply with respect to federal taxes, i.e., the section 6621(a)(2) rate.

We would prefer that the legislation simply fix the interest rate for all deferred tax payments at the applicable nonbankruptcy interest rate. On the other hand, the rate for unsecured taxes under section 804 of H.R. 833 is merely a minimum rate and does not preclude a taxing authority from insisting on a higher rate. Thus, we would not oppose this provision.

Section 805. Tolling of Priority of Tax Claims Time Periods.

Section 805 would suspend the time periods under the Code pertaining to the priority and discharge of tax claims during the pendency of a prior bankruptcy for the period in which the government was prohibited from collecting the claim, plus six months. We support this proposal, but suggest several modifications, outlined below. The filing of successive bankruptcies should not disadvantage governmental units by reducing their opportunity to collect a tax, and should not result in a more expansive discharge of tax claims for debtors. Adding six months to the suspension period mirrors section 6503(h) of the Internal Revenue Code (26 U.S.C.), and is appropriate given the disruption to collection efforts caused by the filing of a bankruptcy petition. The additional time is needed to get collection efforts back on track.

As noted above, we would suggest several modifications to this provision. First, the time periods applicable to employment and excise taxes should be suspended during the pendency of a prior bankruptcy case. Second, this section should be modified to suspend time periods in which collection was stayed under the terms of a confirmed plan under chapters 11, 12 or 14, plus six months. Third, the Internal Revenue Service Restructuring and Reform Act of 1998 gave taxpayers new rights to appeal collection actions that, when invoked, have the effect of staying collection. Thus, the time periods should also be suspended while the IRS is prohibited from collecting as a result of an appeal of a collection action taken under applicable nonbankruptcy law.

Section 807. Chapter 13 Discharge of Fraudulent and Other Taxes.

Section 807 would generally conform the discharge of tax claims in chapter 13 cases to the discharge of such claims available in chapter 7 cases. We support this provision. Under current law, priority tax claims for which a proof of claim is filed must be paid in full pursuant to the plan, and if a proof of claim is not filed, such taxes may be discharged. Taxes

attributable to fraud or unfiled returns can be discharged upon completion of all payments under the plan, but many jurisdictions permit plans providing for "zero payment" of taxes, or plans distributing payments covering only small percentages of such claims. Permitting taxes attributable to fraud, or for which returns have never been filed, to be discharged on the basis of a tax evader's commitment to make payments to his or her creditors for three or five years makes bankruptcy a tax haven. In our view, a debtor should be entitled to the same discharge in chapters 7 and 13, as proposed in section 507. Taxes attributable to fraud should be not discharged in a chapter 13 proceeding, and chapter 13 plans should not be confirmed unless prepetition tax returns are filed.

Section 808. Chapter 11 Discharge of Fraudulent Taxes.

Section 808 would deny a discharge to a chapter 11 corporate debtor for taxes that arose because of fraudulent tax returns or an attempt to evade taxes. We support this proposal. Corporations that engage in tax fraud or otherwise attempt to evade taxes should not be entitled to a discharge vis-a-vis those taxes.

Section 809. Stay of Tax Proceedings.

Section 809 would limit the automatic stay applicable to Tax Court proceedings to proceedings regarding a tax liability for a tax period ending before the order for relief, and would clarify that the automatic stay does not apply to an appeal of a decision determining a tax liability of the debtor. We support these proposals. No purpose is served in staying the commencement or continuation of a Tax Court proceeding for taxes incurred postpetition. Moreover, a court of appeals case regarding the liability of a taxpayer for a tax should be allowed to continue to a decision.

Section 810. Periodic Payment of Taxes in Chapter 11 Cases.

Section 810 would amend section 1129(a)(9)(c) of the Code to provide that deferred payments of tax claims under a chapter 11 plan must be made in installments with the result that balloon payments would be proscribed. In lieu of the current five-year payment period measured from the date of assessment, such payments would end on the earlier of five years after the petition date or on the last date on which payments are to be made to unsecured creditors under the plan. In addition, secured tax claims would be treated as priority claims for deferred tax purposes, where such claims would have had priority absent their secured status. We support this provision.

Section 811. The Avoidance of Statutory Tax Liens Prohibited.

Section 811 would resolve litigation over the interaction of section 545(2) of the Code, and the protection accorded certain purchasers of property under 26 U.S.C. §6323 even after a notice of tax lien has been filed. We support the proposal. The purpose of the special treatment for such purchasers is to facilitate the flow of these goods in commerce. Debtors would receive a windfall if section 545(2) of the Code applied to tax liens.

Section 814. Income Tax Returns Prepared by Tax Authorities.

Section 814 would confirm the exception from discharge for taxes relating to unfiled tax returns when substitute tax returns are prepared by taxing authorities. For tax purposes, a tax return prepared by the IRS is not considered a tax return, unless it is signed by the taxpayer. The proposal would confirm that a substitute return prepared by the IRS is not a return for discharge purposes, unless it is signed by the taxpayer. This section further provides, however, that a written stipulation to a judgment entered in a nonbankruptcy court would be treated in the same manner and have the same effect as a signed tax return. We are uneasy at the prospect of having different definitions of ~~tax returns~~ for Internal Revenue Code and Bankruptcy Code purposes. Furthermore, stipulation to a judgment represents a level of cooperation much different in degree and kind than the signing under penalty of perjury of a return prepared by a taxing authority. Thus, we do not support the provision equating a stipulated judgment with a signed return. It would also be helpful to clarify that the term ~~equivalent report or notice~~ applies only to the extent that state or local tax law provides for the filing of an equivalent report or notice, and has no application for federal income tax reporting purposes.

Section 815. The Discharge of the Estate's Liability for Unpaid Taxes.

Section 815 would absolve the debtor's estate of liability for administrative taxes after a request for a prompt audit is made in accordance with section 505(b) of the Code. Several courts have held that while a trustee, the debtor, and a successor to the debtor are discharged from liability for administrative period taxes after a prompt audit request is made, the estate remains liable for any taxes uncovered by a taxing authority in a subsequent audit. We oppose the proposal to extinguish the liability of the estate. Section 505(b) already protects the trustee, the debtor and the debtor's successors from liability, and extinguishing the liability of the estate for taxes that it should have reported on its return will result in an unjust windfall for other creditors.

Section 816. Requirement to File Tax Returns to Confirm Chapter 13 Plans.

Section 816 would require chapter 13 debtors to file tax returns due for three years prior to the petition date. Tax authorities are placed at a severe disadvantage in preparing and filing timely proofs of claim when a chapter 13 debtor has ignored his or her tax return filing obligations. Outside of bankruptcy, the IRS will typically ask a delinquent debtor to file tax returns for the prior six tax years. We submit that the Code should similarly require the filing of delinquent tax returns for six years rather than for three years, and we therefore urge that this provision be modified accordingly.

Section 818. Setoff of Tax Refunds.

Section 818 would create an exception to the automatic stay allowing taxing authorities to set off prepetition tax refunds against prepetition tax claims. We support this proposal.

Even when consumer bankruptcy filings were a mere 300,000 cases a year, the cost to the government of filing lift stay motions for relief from the automatic stay in order to effect a setoff of tax refunds would have been significant. With consumer filings now surpassing 1.3 million cases a year, the cost of filing such lift stay motions would be prohibitive. Given the number of cases in which refund offset arises, the solution is to permit taxing authorities to use the administrative processes that apply outside of bankruptcy rather than dealing with the issue on a case-by-case basis using a litigation model.

We urge addition of a new provision in this title: **Tax Year that Straddles the Petition Date.**

H.R. 833 should be amended to include an additional tax-related proposal to clarify the bankruptcy treatment of a tax year that straddles the petition date. The position of the Government is that an income tax is incurred on the last day of the tax year inasmuch as a taxpayer's liability for tax cannot be calculated until all income has been accrued or collected, and all deductions have been accrued or paid. Moreover, until the debtor reports its income tax liability, a taxing authority is not in any position to prepare and file a proof of claim. Nonetheless, several courts have held that a tax year straddling the petition date should be treated as partially a prepetition year and partially a postpetition year. In re O'Neill Shoe Co., 64 F.3d 1146 (8th Cir. 1995); In re Pacific-Atlantic Trading Co., 64 F.3d 1292 (9th Cir. 1995); and In re Hillsborough Holding Corp., 115 F.3d 1391 (11th Cir. 1997). Under these decisions, the

prepetition portion of the year is treated as a priority tax, while the balance is treated as an administrative tax. These decisions create the opportunity for considerable mischief, particularly if the time for filing a proof of claim will run prior to the due date of the return in question. Furthermore, to the extent that straddle years are treated as prepetition tax years, debtors can stretch out the payment period for the related tax liability for five years under chapter 11 instead of paying the tax in full in cash on the effective date of the plan.

We submit that the Code should be amended to clarify that an income tax liability is incurred on the due date of the date return for purposes of determining whether a tax is entitled to administrative expense or priority treatment. Clarification is needed because bankruptcy petitions are rarely filed immediately after the due date of the return so that this issue can potentially arise in virtually any case.

TITLE IX: ANCILLARY AND OTHER CROSS-BORDER CASES

Section 901. Amendment to Add Chapter 15 to Title 11.

Section 901 adds a new chapter to the Code to be codified as Chapter 15. This chapter would address insolvencies which cut across international borders. We generally support these provisions, with the following exceptions.

Proposed section 1507 allows the court to provide the representative of a foreign insolvency ~~additional assistance~~ based upon standards that are vague and duplicative of section 304 of the Code. This approach is inconsistent with the purpose of the cross-border chapter; namely, to create new and better treatment for international bankruptcies.

We also oppose proposed sections 1519 and 1521 to the extent they grant the court open-ended authority to enjoin anything needed to protect assets and creditors. As written, the sections are overbroad.

TITLE XI: TECHNICAL CORRECTIONS

Section 1130. Trustees.

Section 1130 of H.R. 833 would amend section 586 of title 28, United States Code, to establish procedures for judicial review of decisions by a United States Trustee to either terminate or suspend from a panel of trustees or as a standing trustee, and decisions to deny an expense request by standing trustees.

As an initial matter, the Department supports clarifying and improving the judicial review already available trustees who are aggrieved by the actions of the United States Trustee Program. Historically, a decision to terminate or suspend a trustee from the panel of trustees was not subject to judicial review. E.g., Joelson v. United States, 86 F.3d 1413 (6th Cir. 1996). In response to concerns about a lack of judicial review, the Department promulgated an administrative rule giving private trustees the ability to seek judicial review under the Administrative Procedure Act (~~APA~~), 5 U.S.C. § 552 et seq. of any action by the Department to suspend or remove a trustee from future case assignments. 28 C.F.R. § 58.6. The Department believes that standing trustee budget disputes are already subject to judicial review under the APA. In addition, the United States Trustee Program has implemented procedures for mediating standing trustee budget disputes.

Notwithstanding its position that review is available under the APA, the Department engaged in negotiations with the affected parties and Congressional staff and after much effort, a compromise was reached. Unfortunately, due to what appears to be a typographical error, Section 1130 does not reflect the compromise. Section 1130(b) sets forth the standard of review for standing trustee expense requests. This standard, unlike the proposed standard for review of trustee termination and suspension, is whether the decision is ~~unreasonable~~ or without cause. The standard of review should be revised to ~~unreasonable and without cause~~ in keeping with the compromise. Provided that this correction is made, the Department will strongly support section 1130.

* * * *

Finally, as noted in our comments above, many of the provisions set forth in this bill would impose substantial burdens on the United States Trustee Program. Currently, the Trustees program is fully self-funded through fees. However, to implement the requirements of this bill, the Trustees would be required to expend tens of millions of dollars that will diminish their ability to fulfill their other responsibilities, and this, in turn, will diminish the efficiency of the bankruptcy system. We therefore request that a special appropriation be authorized for each provision that imposes a new burden on the United States Trustee Program.

We look forward to working with the Committee as it considers these and other issues raised by H.R. 833. The Office of Management and Budget advises that it has no objection to the submission of this letter from the standpoint of the Administration's program.

Sincerely,

Dennis Burke
Acting Assistant Attorney General

BRIEFING ON BANKRUPTCY REFORM
Background for March 17, 1999 meeting with retail creditors

I. SUMMARY OF LAST YEAR'S DEBATE

Last year, the Administration expressed its strong opposition to the House bankruptcy reform bill, H.R. 3150.¹ We encouraged passage of the Senate bankruptcy reform bill, S. 1301, "as an important step toward balanced bankruptcy reform," but noted that the Administration would support its enactment "only if the essential reforms incorporated by the Senate managers' amendment [were] preserved and strengthened and the unbalanced and arbitrary elements of the current House bill [were] omitted."² We believed that the extraordinary bipartisan support for the Senate bill was an endorsement of balance and moderation. We noted that even the Senate bill could be further improved to better protect the rights of debtors.³ We were sorely disappointed when the Conference Report "contain[ed] many flawed aspects of the House bill and fail[ed] the test of balance."⁴ The President's senior advisors recommended that he veto the Conference Report.⁵

II. ACTIVITIES THIS YEAR

Rep. Gekas, along with 44 Republicans and 27 Democrats (including Reps. Boucher, Kennedy, Holden, Menendez, Roemer, Maloney, Velazquez, etc.), has reintroduced last year's Conference Report as H.R. 833. Hearings are ongoing in the House this week. Subcommittee Chairman Gekas has represented that the hearings are really just a nod to the Judiciary Democrats so they can not complain about process. He thinks the issues have been fully vetted. There is little sign that the bill proponents intend to compromise on key issues.

Ranking Democrats Conyers (on full Judiciary) and Nadler (on the relevant subcommittee) have been working with bankruptcy experts to try to craft a serious effort at reform (unlike Nadler's bill last year that was largely designed to make a point). They have written to the President asking him to weigh in again on the importance of balance and moderation in hopes of strengthening their hand.⁶ However, our assessment is that we will again face overwhelming support for the bill in the House. (Note that Gephardt voted for the Conference Report last year.)

¹ June 10, 1998, SAP on H.R. 3150, the House bankruptcy reform bill.

² September 17, 1998, SAP on S. 1301, the Senate bankruptcy reform bill.

³ Id.

⁴ October 9, 1998, letter from Jack Lew to Senator Lott.

⁵ Id.

⁶ March 4, 1998, letter from Representatives Conyers and Nadler to the President.

In the Senate, Senator Grassley has been working with Senators Biden and Torrecelli, both of whom are expected to co-sponsor his bill to be introduced on Tuesday, March 16. The Grassley bill is also modeled after the Conference Report of last year, but he has made some significant movements in our direction. However, the bill remains seriously problematic in a number of areas. Torrecelli told the First Lady that he planned to send a letter to Grassley indicating that his support was conditional (*i.e.*, he would oppose the bill on the floor unless further changes on a few key issues were made). We have not yet seen that letter.

Like last year, our best hope for a moderate bill is with the Senate. If a bill we do not like leaves the Senate, the prospects for something better coming out of conference are very slim. We expect Judiciary Committee mark-up of both the House and Senate bills as early as next week.

III. CURRENT ADMINISTRATION POSITION

We have a draft letter to Nadler and Conyers in clearance (may be ready before the Wednesday meeting) reiterating the Administration's concerns from last year on key issues. (See talking points.) DoJ is also preparing detailed comment letters on the Conference Report and the Grassley bill to send before the mark-ups. We are working closely with Senate Judiciary Committee Democrats to help them to try to win concessions, but we have not entered into direct negotiations with the Republicans ourselves, as we do not want to alienate the more liberal Democrats.

TALKING POINTS
BANKRUPTCY REFORM
March 17, 1999

- The President supports responsible bankruptcy reform that is balanced, would reduce abuses of the bankruptcy system, and would require debtors and creditors alike to act responsibly. The President was disappointed that the last Congress failed to produce legislation that he could support. He remains hopeful that bipartisan consultation and compromise will produce legislation that he can enthusiastically sign this year.
- Last year, we believed that the extraordinary bipartisan support for the Senate bill was an endorsement of balance and moderation. We noted that even the Senate bill could be further improved to better protect the rights of debtors. We were sorely disappointed when the Conference Report went the other direction, failing the test of balance.
- We believe that the path to legislation is bipartisanship and balance. We want to avoid a situation like last year, but we are prepared to hold firm if the balance that the President seeks is not there.
- During this year's debate, the Administration will continue to encourage Congress to find an appropriate balance. Our concerns from last year have not changed. Among the issues that must be addressed are:
 - **Access to Chapter 7:** Any "means test" imposed should deny access to Chapter 7 only to those who genuinely have the capacity to repay a portion of their debts successfully under a Chapter 13 repayment plan. Thus, bankruptcy courts must have discretion to consider the specific circumstances of a debtor in bankruptcy, and the time periods and thresholds used should be set to ensure that only those with a strong likelihood of success are affected.
 - **Nondischargeable Debts:** It is inappropriate to create new categories of nondischargeable debts that could pit post-bankruptcy credit card debt against child support, alimony, educational loans, and taxes. We continue to be skeptical that a case has been made that the existing protections against abuse are inadequate in this regard. If these new categories are to be created, they should cover only that debt: (1) incurred to pay nondischargeable debt with an intent to avoid the debt in bankruptcy; and (2) incurred on the eve of bankruptcy for goods or services that are not reasonably acquired to support the debtor's household.
 - **Coercive Debtor Practices:** Particularly if we are to provide new opportunities for creditors to challenge debtors' use of the bankruptcy system under the 707(b) abuse test, it is imperative that we adequately limit prevalent abusive creditor practices such as coercive reaffirmations and violations of the automatic stay. While the Senate bill initially took laudable steps in this direction, the Conference Report rolled back existing consumer protections by denying consumers an

effective means for remedying the harm from such practices and eliminating the current authorization for penalties for intentional violations of debtor rights.

- **Credit Card Disclosures:** The challenge posed by the unprecedented level of bankruptcy filings requires us to ask greater responsibility of debtors and creditors both. Credit card companies must give consumers more and better information so that they can understand and better manage their debts.
- **Homestead Exemptions:** At the same time that we are creating a system that will deny certain moderate-income Americans access to the traditional “fresh start,” we should also close the loopholes that allow the wealthy to shield hundreds of thousands of dollars of wealth from their creditors.
- We look forward to working with members of Congress both sides of the aisle to address these and others important concerns and produce responsible, balanced bankruptcy reform.