December 5, 2006

Hon. Jeff Sessions
Chairman
Senate Judiciary Committee
Subcommittee on Administrative Oversight and the Courts
Washington, D.C.   20510

RE: December 6, 2006 Hearing on BAPCPA

Dear Mr. Chairman:

Attached please find the Transcript of Proceedings from the American Bankruptcy Institute’s “A Year After BAPCPA” program, held October 16, 2006 at Georgetown University Law Center. This program, supported with the financial help of the Financial Services Roundtable, featured a balanced mix of practitioners, judges, government regulators and academics. The program covered the one year experience, post BAPCPA, in both consumer and commercial bankruptcy. The program featured both creditor and debtor interests, covering issues from credit counseling to means testing and the effects on commercial cases, among other issues.

As you know, the American Bankruptcy Institute does not take advocacy positions before Congress, but is rather a neutral source for information on developments in bankruptcy law. We hope this transcript can be included in the official record of the December 6 proceedings as ABI’s contribution to a fuller record. Please let us know how we can further assist the committee’s work.

Sincerely,

Samuel J. Gerdano
Executive Director
A Year After

How the Bankruptcy Abuse Prevention and Consumer Protection Act Has Impacted Bankruptcy Practitioners, Lenders, Consumers, Turnaround Managers and Trustees

October 16, 2006
Georgetown University Law Center
Washington, D.C.

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American Bankruptcy Institute  
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October 16, 2006  

Good Morning: I’m Sam Gerdano, Executive Director of the American Bankruptcy Institute. ABI is a nonprofit, nonpartisan professional association of more than 11,000 members involved in the bankruptcy process – lawyers, accountants, financial and restructuring professionals, judges, academics, lenders, and others in the insolvency community. We are not an advocacy group and represent neither creditors nor debtors, but rather provide a forum for the exchange of ideas on both legislative policy and issues facing the courts.  

Today’s program is the product of a steering committee selected to ensure that all points of view on some controversial issues are heard. The committee was chaired by bankruptcy judge Dennis Dow and Professor Jean Braucher of the University of Arizona College of Law. The committee was staffed by ABI’s Deputy Executive Director, Ann vom Eigen. Each panel today will be moderated by a member of the steering committee. We thank the committee and staff for their many months of outstanding work leading up to today.  

Our goal is to produce a comprehensive record for Congress on the first-year experience covering both consumer and business bankruptcy developments. We thank in advance our many
presenters for their commitment to this goal. We also thank our host, Georgetown University Law Center, and our financial sponsors - the Financial Services Roundtable, the Law Firm of Baker & Hostetler, and the National Data Center for their very important support. We welcome many members of the press. Our speakers know that their comments are on the record.

A full transcript of the proceeding is being made and will be available on the ABI web site in the future. Today’s program is also being webcasted live and we welcome those joining us electronically as well.

Some final housekeeping announcements - please turn off or otherwise silence cell phones. For those seeking CLE credit, you will receive an e-mail from ABI with a link to your certificate of completion about a week from today. Our lunch program is on the top floor of the Gewirz building here at the Law Center, diagonally across from the quad on the F Street entrance. We will have plenty of staff people to guide you to and from there. Restrooms are located right outside this auditorium on the main level. There are also computers available on the third floor of the Law School.

Finally, there are some survey forms in your materials bags and we hope that you will take a moment at some time during the program to complete them and return them to the main desk. We very much value your feedback. The full biographies of all the presenters are in your materials book.
Serving as today’s moderator and to introduce the panels is the honorable Dennis Dow. Judge Dow serves as a bankruptcy judge in the Western District of Missouri, sitting in Kansas City. Prior to taking the bench, he was a partner in a major Kansas City law firm. He is also a co-chair of ABI’s Consumer Bankruptcy Committee.

With that I would like to welcome Judge Dow to come up and introduce the moderator for the first panel. Judge Dow.

Dennis R. Dow: Good morning. I would like to add my welcome to that of Sam on behalf of the American Bankruptcy Institute. As all of you are very well aware, in April of 2005, President Bush signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which I will refer to in deference to Judge Wedoff who champions this acronym, and in the absence of a better one, is BAPCPA, although others have referred to it in different ways.

The legislation that was enacted after a very long legislative process, most of the provisions became effective almost exactly one year ago today. Many extensive changes were made to the Code, the most extensive one since the enactment of the Bankruptcy Code in 1978, most of those changes were made in the consumer area, but significant changes were made in the area of Chapter 11 as well, and an entirely new chapter was added on Cross-Border Insolvencies.
As Sam mentioned, our goal today is to assess the impact of those changes on the bankruptcy process and on all the variance constituencies that participate in bankruptcy cases – debtors, debtors’ counsel, creditors, the United States Trustee, and the courts. While we will talk about some case law developments and interpretation of the courts of new provisions of the Code, our goal today is not necessarily to provide you with a case law update, but a comprehensive look at the impact of the new legislation and the various factors that affect bankruptcy filings and outcomes in bankruptcy cases. We will assess where we are and where we are likely to go.

Among the topics that we are going to discuss this morning will be the effect of the legislation on the number and composition of bankruptcy filings; the availability and efficacy of credit counseling, now an eligibility requirement for individual debtors; changes to Chapter 11 practice, how they affect the dynamics in large cases; and the impact on individuals of changes to Chapter 11 whether new information requirements and process changes have enhanced the process for viable small-business debtors and assisted the courts in sifting out the nonviable ones; the effect and interpretation of the means test designed to channel debtors to Chapter 13 and enhance creditor recoveries; the impact on debtor’s counsel of new duties and liabilities; and the effect of new restrictions on the attorney-client relationship; and how proposed new and
revised rules will affect the processing of bankruptcy cases and issues raised by changes reflected in these new rules and official and procedural bankruptcy forms.

In many areas, there may be insufficient experience and data to draw conclusions. In other areas, trends are emerging from which some sense of a future might be gleaned. We hope you find the conference and the assessments made enlightening and thought-provoking. Sam mentioned the steering committee. I would like to thank them by name.

Melyssa Barrett who is the moderator for our first panel was a member of that committee. Suzanne Boas from Consumer Credit Counseling of Greater Atlanta, Professor Jean Braucher of the University of Arizona, Roberta DeAngelis from the office of the United States Trustee, Larry Friedman from eCAST Settlement Group, Ricardo Kilpatrick of Kilpatrick and Associates, John McMickle from Winston and Strawn, Travis Plunkett from Consumer Federation of America, Jennifer Smith from the Financial Services Roundtable, and Lynn Tavenner from Tavenner & Beran.

Our first panel will address the macroeconomic issues in connection with the amendments to the Bankruptcy Code. The data show that filings are down, and the composition of cases has changed. A higher percentage of them, at least for the time being, are Chapter 13 cases. Recent data indicate filings are trending back up. What factors are they correlated to?
What economic factors? And what do those economic indicators tell us about where the filings will go? Do those data indicate whether the law is having its intended effects? Those are some of the questions the first panel will explore.

And here to introduce the panelists and moderate the discussion is Melyssa Barrett, who is a member of the ABI Board of Directors and a director of Visa USA. Melyssa.

Melyssa R. Barrett: Thank you, Judge Dow, and welcome everyone. This event is designed to assess the effect of bankruptcy reform one year later. As Judge Dow mentioned, there has been a very distinct change in the number of bankruptcy filings, but it is a bit early to come to any firm conclusions about the trends. This panel will explore a variety of areas, including the mix of cases, how the bankruptcy law is working, as well as whether the intended effect is being realized.

One thing we know for sure is that consumer bankruptcy filings are about 70 percent lower than they were. I do not know if the reduction in bankruptcy filings is a part of the trend or if it is a specific blip, but we are certainly in a new environment when it comes to bankruptcy filings.

One question hopefully that we will be able to address is the effect of the reductions in consumer bankruptcy filings on the economy. I know Senator Grassley, the lead sponsor of BAPCPA, gave a speech a few weeks ago that expressed the view
that high levels of bankruptcy filings create a drag on the economy and the decrease in filings has helped the economy. So hopefully, we will get some perspective from our panelists on this suggestion. In addition, I would like to see if the panel would also talk a little bit about how to measure the economic effects of reduced.

The panelists have each prepared remarks and we will take questions after they have completed their presentations.

So with that, I would like to introduce you to our esteemed panel who will discuss the macro overview of the impacts of BAPCPA. Sitting next to me is Michelle White. She is the Professor of Economics at the University Of California-San Diego and a research associate at NBER. She received her PhD in Economics from Princeton University and was formerly a faculty member at the University of Pennsylvania, New York University, and the University of Michigan. She has been a visiting scholar at Harvard Law School, Berkeley, among other schools - her accolades and education go on and on. She taught in the American Economics Association’s Master’s Degree Program in Beijing, and the PhD program at the New Economics School in Moscow. She has been a Fulbright scholar, an associate editor of the Journal of Economic Perspectives and a current or former editorial board member of the American Law and Economics Review. In the past several years, her research has focused on the personal bankruptcy system in the U.S., why households file
for bankruptcy, how bankruptcy affects the decision to become an entrepreneur, the effects of bankruptcy on availability of credit to individuals and small business, and the effects of the recently adopted U.S. Bankruptcy reform.

Clifford White is the Acting Director of the Executive Office for the United States Trustees. He has served in the federal government for 26 years, including previously as an assistant United States trustee and a deputy assistant attorney general within the Department of Justice, and as assistant general counsel at the US Office of Personnel Management. He is an honors graduate of the George Washington University and the George Washington University Law School. In July 2003, Mr. White was also recognized with an Attorney General’s award for distinguished service.

Teresa Sullivan is a Provost and Executive Vice President for academic affairs at the University of Michigan. She is also Professor of Sociology in the College Of Literature, Science and the Arts. Dr. Sullivan was executive vice chancellor for academic affairs for the University of Texas System and she was the chief academic officer for the nine academic campuses within the University of Texas System. She also has a variety of research and her research focuses on labor force, demography, with particular emphasis on economic marginality and consumer debt. She is the author or co-author of six books and more than 50 scholarly articles, and her most
recent work explores the question of who files for bankruptcy and why.

So with that, I would like to welcome our esteemed panel this morning and would like to ask Cliff White to begin with his remarks.

Cliff White: Very well, thank you. Let me thank the American Bankruptcy Institute for the opportunity to participate this morning. ABI plays a critical role in improving bankruptcy practice through seminars like this and its publications, and by providing today’s forum to review the changing landscape of the bankruptcy system, once again ABI is making another significant contribution to the bankruptcy professionals and policy makers that it serves.

What I want to do this morning is discuss with you the progress made by the US Trustee Program in doing our part to make bankruptcy reform work for all stakeholders in the system, which means debtors, creditors, and the general public, and I’ll focus my oral presentation this morning on the consumer provisions of BAPCPA in which the U.S. Trustee plays a critical role.

Now let me begin by saying that my general conclusions are that the consumer provisions of the reform law are workable. An initial result shows promise for making long-lasting improvements in the bankruptcy system. Now these accomplishments are due to the good faith and incredibly hard
work of dedicated professionals in the U.S. Trustee Program and in the larger bankruptcy community including the judges and so many others who are in the audience today. But I believe we can make faster progress down the road, however, if the tenor of debate can be elevated a bit and if bankruptcy professionals make a greater effort to breed respect for the rule of law.

In the wake of the most comprehensive bankruptcy reform legislation in a generation, we have seen, as was alluded to earlier, a roller coaster in bankruptcy filings. More than 600,000 petitions were filed in the two-week period before the general effective date of the law, before October 17, 2005. In the 11 months thereafter, there were fewer than 500,000 filings. Now filings are now trending upward and now it appears, I heard, about 40 percent of pre-BAPCPA filing rates.

Now another important change in the filing trends has been the mix of Chapter 7 and 13 cases, whereas, fewer than 30 percent of all cases were filed under 13 before reform, they now account for about 40 percent of all filings. Chapter 11 cases are down overall about 20 percent. Now these and other data will provide for much academic and practical discussion in the weeks and months ahead. And for the US Trustee program and others who are responsible for enforcing and implementing the law, we need to continue to review the data and search for the information that is going to help us do a better job and meeting our obligations under bankruptcy reform.
Now let me start my discussion of the subs in the provisions of reform with means testing because in so many ways, means testing is the cornerstone of BAPCPA. Under the new 707B, the former subjective substantial abuse standard is now replaced by a more objective means test formula to determine whether a case is presumed abusive. It is too early to tell the long-term impact of means testing on the bankruptcy system, but let me suggest two preliminary conclusions.

First, means testing is workable. There is a system in place by which debtors are able to transport the necessary IRS and Census Bureau information and make required calculations. In large part, this was a product of rules and forms developed by the judicial conference with input by the United States Trustee and by again, the diligence of the other bankruptcy professionals in the system.

Now I need to add a couple of important caveats to that optimistic assessment though. For example, many debtors and their lawyers still do not fill out the means testing form properly. The calculations are not always reliable, and that puts a significant burden on the U.S. Trustee and the private trustees and the courts, but the anecdotal evidence suggests that the quality of the file forms is improving but debtor’s counsel still are somewhere on the learning curve.

Another important reason I tend not to draw firm conclusions is because the number of filings has been extremely
low since October 17 as we have discussed. So there is no way to be absolutely certain, 100 percent certain, that we are going to be able to process the large number of cases due the means testing calculations, make the determinations of presumed abuse with the same efficiency in the future as we have in the past.

My concern about long-term, making a long-term promise on that grows really largely out of the fact that the judicial conference has not yet mandated smart forms with data tags that would allow us to automate most of our procedures for the benefit of U.S. Trustees, Chapter 7 Trustees, and others. Data still largely has to be manually pulled out and means testing analysis performed, but we are hopeful that in 2007, the judicial conference will do that.

Now my second preliminary conclusion is, that early data suggest means testing does in fact institutionally for the system, provide a promising approach, or at least early indications are that it provides a promising approach. Of the individual debtors who filed from October 17 through the end of June, 94 percent were below the median income level. Now, of those above the median income level, the U.S. Trustees determine that slightly less than 10 percent were presumed abusive. And of the presumed abusive cases that did not voluntarily convert or dismiss, the U.S. Trustee filed motions
to dismiss in about three-quarters of those cases, and declined to file in about one-quarter of the cases.

So to us, these data suggest that means testing is a useful screening device to identify abusive cases. They also suggest that the statute provides the U.S. Trustee with sufficient discretion so that decisions on filing motions to dismiss can be made on a case-by-case basis and not solely based upon a statutory formula.

Another major aspect of bankruptcy reform is financial education. As you know, individual debtors must now receive credit counseling prior to filing a petition and receive debtor education prior to receiving a discharge. Now, these are potentially the most far-reaching consumer protection provisions of the Code. These requirements, I call them consumer protection provisions, because their purpose is to ensure debtors, when entering bankruptcy, know what their options are and that they exit bankruptcy with tools that might help in the future to avoid future financial calamity. So the job of the US Trustee is to approve providers who meet statutory qualifications to offer these services. This function was entirely new to the U.S. Trustee Program and has required enormous effort on our part to carry it out effectively.

Now, when asked with means testing, I would suggest to you that there are positive early signs that credit counseling and
debtor education is workable. The credit counseling industry has been a troubled one. Our first priority was to develop a system to screen out those who might seek to defraud debtors, and importantly it appears that we have been successful so far. We developed our approval in monitoring criteria with enormous assistance from the internal revenue service and the Federal Trade Commission, and our procedures have been generally well reviewed by representatives of consumer groups, creditor groups, and others.

It is almost inevitable that eventually a bad actor may get through the screening system but we are much relieved that the initial efforts appear to have been effective. Beginning in September just last month to further strengthen our efforts, we commenced a series of post-approval on-site reviews of credit counseling and debtor education providers to better verify the applicant’s qualifications.

Now another important positive sign that credit counseling and debtor education can work is that there is, to date, adequate capacity to serve the debtor population. Again, of course, the true test is going to come when filings reach higher levels in the future. At the end of last August, we had received nearly 700 initial applications from credit counselors and debtor educators. About 64 percent of those applications were approved, a little under a third were either denied or
voluntarily withdrawn and the five percent or so were still under review.

Moreover, nearly all credit counselors and debtor educators who had received probationary approval applied again for a 12-month period. We have not had any diminution in capacity during the period since BAPCPA. So currently there are 153 credit counseling agencies and 275 approved debtor educators.

Now in addition to approving the applications, the U.S. Trustee is also a major enforcer of the requirement, that debtors receive the credit counseling. And we expected that verification process is going to become easier in the future again because of some work by the judicial conference and the Bankruptcy Rules Committee which issued a new official form effective October 1st, which will provide clear notice to all debtors with the petition, especially the pro se debtors, that they have the requirement to obtain credit counseling or otherwise show that they made other criteria so that their case can go forward. We hope that this system will decrease the number of enforcement actions that we are required to take and we have taken about 2,500 enforcement actions in addition to the kind of show cause orders and other papers that are automatically issued by clerk’s offices in a number of cases.

Now finally, I will just comment, we did issue interim regulations governing applicant qualifications and do expect to
publish more extensive rules and the more extensive notice of proposed rule-making in the next few months, where we might be able to address some other issues not squarely covered by statute, but which keep being raised in the course of our implementation, such as the fee waiver issues and restrictions on perceived abuses of the system by debtor’s counsel and others. The U.S. Trustee Program is learning more everyday and will continue to do, we believe, we hope, an increasingly better job as we gain some experience and expertise in carrying out these new duties.

The final area of bankruptcy reform I want to highlight is the new system of debtor audits, and this is in some ways a preview of coming attractions because the debtor audit provisions do not become effective until this Friday, October 20th. And by law, the U.S. Trustee Program then must commence a series of debtor audits which are designed to verify the accuracy of schedules filed by individual Chapter 7 and Chapter 13 debtors.

Now, this regimen of audits, we believe, is going to help us identify cases of fraud and abuse, will enhance deterrence, and also help provide some baseline data to gauge the magnitude of fraud abuse scenarios in the bankruptcy system. In the next fiscal year, fiscal year 2007, that is the 12-month period that just began on October 1, we are going to use contractors to conduct up to 7,000 audits, where audits are going to be
conducted on at least one out of every 250 individuals, 7 and 13 debtors in each judicial district. And we anticipate between 1,000 and 2,000 audits of cases in which debtors have income or expenses at substantial variants from the norm.

The procedure will work sort of as follows: Shortly after a case is filed, selected debtors with their counsel will receive a notification of audit and a request for documents and we hope that those audits will be completed within 70 days after schedules are filed. And reports of the audits will be filed with the court by the auditors themselves. It is not our intent to file an extension of time except on unusual circumstances because the statute provides that a discharge may be revoked if the auditor finds a material misstatement that is not adequately explained or the debtor fails to provide necessary information.

The U.S Trustee Program also is responsible for enforcing and implementing a number of other provisions of BAPCPA. For example, we have carried out new duties in the area of small business Chapter 11 cases to take actions and in larger cases to take actions to enhance management accountability in large corporate reorganizations. We have had to defend numerous legal challenges to the Reform Law and participated in other litigation that present issues of first impression that have to be sorted out through case law. And in addition, we are working now to produce required studies and reports, including
study on the effectiveness of debtor education, the application of the IRS standards to the means test and the impact of the new definition of household goods. Although the amount of work and demands imposed on the program have been immense, we believe that we are on track and have made substantial progress, and hope that we are getting the job done and, as I say, will only improve as time goes on.

Now, the other matter I wanted to discuss with you today is what I also believe to be an essential ingredient to making bankruptcy reform work effectively and fairly for all constituents in the system. It is important that all professionals who are a part of the system elevate the discussion about bankruptcy reform law and practice. I think we are at a point where we should no longer indulge in the kind of strident rhetoric that tends to undermine the rule of law. Instead, bankruptcy professionals, I would suggest, have an obligation to show good faith and respect for law.

The ABI has long been noted for its scholarship and professional quality of its programs. This organization advances the public discussion about bankruptcy law policy and practice. Today’s program follows in that tradition. I would suggest we need ABI’s leadership in this area and enriching the discussion now more than ever. Because if we are to make bankruptcy reform work, regardless of the individual views on the wisdom of specific provisions of the law, that it is
incumbent upon all of us, all bankruptcy professionals, to promote fundamental respect for the rule of law. Public statements that are unconstructive and attack the integrity of the law undermine public confidence in the legal system. This point has been made by many others in the system who has expressed some concern about the strident rhetoric that continues to emanate from a few in the bankruptcy community.

My colleagues and I in the U.S. Trustee Program, and I’m sure many of you, have attended conferences where panelists express strong opinions and that is entirely appropriate. But we also hear and read commentaries from esteemed bankruptcy professionals that tend to mock or denigrate the law. And we regularly hear and read still ad hominem on proponents of reform. Coarse references to reform law are sometimes repeated at several conferences. I would suggest that this rhetoric, and that behavior does not serve the cause of the others, and does not serve the cause of the general public of making reform work.

So I simply make this simple point, that without respect for the law, it is more difficult for the U.S. Trustee to enforce the law, it is more difficult for the debtors’ lawyers to obtain their clients’ compliance with the law, and it is less likely that decisions of the court are going to receive the respect that is essential to our system of government. Our appointed Chapter 7 and 13 trustees have an especially
important stake in breeding respect for the law, because they depend on financial information that is produced in what is largely a self-reporting system. If debtors are told that certain disclosure requirements are without merit, then it is less likely that debtors are going to diligently and conscientiously satisfy their obligations under the Code. I hope that at future conferences, seminars, and debates about bankruptcy reform, we will all hear less invective and more thoughtful analysis about how all of us, policy-makers and lawyers, can enhance the integrity and the efficiency of the bankruptcy system.

So, again, I appreciate the chance to share a few thoughts this morning. This is a valuable program on the one-year anniversary of BAPCPA, and while it is premature to draw firm conclusions on the effectiveness of the reform law, we believe in the U.S. Trustee Program that the new requirements are proving workable and there is evidence of promising results that down the road will benefit debtors, creditors, and the public. I look forward to your questions later. Thanks.

Melyssa R. Barrett: Thanks, Cliff. With that, I would like to turn the microphone over to Michelle White. Her presentation is not found in the materials, but you can follow it along on the screen.

Michelle White: Thank you. I’m an economist and so I’m going to have an economist’s take on this. I’m not going to
review the laws since I assume that you all know it much better than I do. Let me start by talking about the way economists see the function of bankruptcy law, i.e., what is its purpose from an economist’s point of view.

There are two major objectives. One is to provide debtors with some insurance for their consumption by discharging some debt when ability to pay falls. The purpose is to reduce what we call the social costs of debt, which are the real economic costs that are incurred when people's consumption drastically goes down. Illnesses becoming disabilities because debtors cannot afford medical care, debtor’s kids leave school to work, debtors families become homeless, etc.. The other objective of bankruptcy is to protect creditors by having a state-sanctioned system for resolving debt, punishing default and discouraging debtor opportunism. This aspect of bankruptcy reduces the cost of borrowing and increases the amount of credit that is available to debtors.

Now let me talk about opportunists versus non-opportunists, which is economics-speak for two extreme types of debtors. One type, the non-opportunists, are more likely to file for bankruptcy when doing so is more financially worthwhile, but they do not plan in advance for bankruptcy. This means that they tend to file only when their ability to pay drops substantially because they lose their jobs or have health problems or the like.
The other type, the opportunists, are the planners. They plan in advance for the possibility of bankruptcy, and they act to maximize their gain if they do file. There are many well-known bankruptcy planning strategies. One strategy is to borrow as much as possible in the form of dischargeable debt, before filing, another is to convert assets to forms that are exempt in bankruptcy, before filing. These debtors often can afford to repay a substantial amount of their debt.

So how do these two groups make their bankruptcy decision? Well, it is easy to write down an accounting statement for when debtors gain financially from filing for bankruptcy, which says that the amount of debt that is discharged in bankruptcy is greater than the amount debtors must repay in bankruptcy, plus the costs of filing. The costs include all new filing requirements as well as actual out-of-pocket costs, including the costs of credit counseling and financial management courses.

Before BAPCPA, this financial calculus resulted in a level of wealth that I call a threshold. If debtors’ wealth was the threshold, they gained from filing, and if their wealth was above the threshold, then it was not worth filing. For opportunists, the bankruptcy decision is basically the same, but they follow planning strategies that increase their gain from filing. Now there is a graph that shows debtors’ wealth on the horizontal axis and their earnings on the vertical axis.
The red vertical line is for non-opportunists, and it shows that they gain from filing as long as they are to the left of the red line.

You can see that debtors gained from filing under Chapter 7 regardless of how high their earnings were. This is one of the real problems under the old law. Not all debtors filed for bankruptcy when they would gain from filing, but research shows that the higher the gain, the more likely debtors are to file.

The blue line, which is to the right of the red line, shows the threshold for opportunistic debtors. Because of the strategic behavior that opportunists engage in, they gained from filing at a higher wealth level.

Let me turn now to BAPCPA. It imposes a new means test that regulates debtors to have income and earnings below a certain level in order to file under Chapter 7. In addition, there is a new wealth and debtors gain from filing under Chapter 7 if their wealth is below that new level. This means that debtors gain from filing if they fall inside the region enclosed by the red lines in Figure 2. Here the enclosed region divides into a Chapter 7 region where debtors qualify under the means test, and a separate Chapter 13 region where debtors fail the means test but still gain from filing for bankruptcy under Chapter 13.

What about opportunists under BAPCPA? There are a lot of strategies under BAPCPA for debtors to increase the size of the
gain region, and therefore increase their financial benefit from filing for bankruptcy. Some of the old strategies have been eliminated. For example, the debtors cannot move to Florida or Texas and immediately file for bankruptcy and use the unlimited homestead exemption, but they can use a new million-dollar exemption for retirement accounts. They can also still use Asset Protection Trusts and Tenancy in the entirety.

There are also some strategies that debtors can use to pass the means test, even with high earnings. For example, the means test is based on debtors’ average monthly earnings in the six months before filing for bankruptcy. That means that if debtors lower their earnings before filing for bankruptcy, the means test becomes easier and so debtors may be able to qualify for Chapter 7. Even if debtors do not succeed in getting into Chapter 7, there is a ten-to-one gain from earning less. For every dollar that debtors do not earn in the six-month period before filing, there is a ten-dollar reduction in their obligation to repay in Chapter 13. Debtors can also pass the means test by spending more on categories that are exempt under the means test, for example, mortgage loans, car loans, and current charitable contributions. I have done a few calculations and figured out that debtors could pass the means test even with earnings as high as the 90th percentile of the U.S. earnings distribution, and perhaps higher.
Another possibility is that debtors can avoid the means test completely by opening a business before filing, because the means test does not apply if their debt is not “primary consumer debt.”

So how does this affect opportunistic debtors’ gain region? Figure 3 shows that their gain region becomes large, (it is the area enclosed by the blue line.) The wealth threshold is higher and the income threshold is higher. Within the gain region, the Chapter 13 region has gotten smaller because many more debtors qualify to file under Chapter 7 and they probably prefer Chapter 7 over Chapter 13 where they have to repay from future earnings.

How do the gain regions compare under BAPCPA versus the pre-BAPCPA situation? For non-opportunistic debtors, BAPCPA reduced the size of the gain area, because the cost of getting into bankruptcy is higher, less debt is discharged, and fewer debtors are even eligible to file for bankruptcy because of new restrictions on repeat filings. Since the gain region is smaller, fewer debtors gain from bankruptcy and we expect that fewer will file. For opportunistic debtors, it is a little harder to predict the effect of BAPCPA, because there are still lots of ways to qualify for Chapter 7 even if debtors have substantial ability to repay. And so it looks like the adoption of BAPCPA will mainly discourage filings by non-opportunists.
Let me turn finally to thinking about the relationship between bankruptcy and credit card lenders. Let’s detour just for a second. There has been a trend in credit card pricing toward lower upfront fees and higher penalty fees. We have all received lots of credit card solicitations that offer a zero introductory interest rate, lots of rewards for charging more on your credit card, and zero annual fees. Low upfront fees mean that credit card lenders lose money when people open new accounts. They make up for their losses on new accounts by charging borrowers more when they start to look more risky when they only pay the minimum each month and when they pay late.

These late charges, over-limit charges, and penalty interest rates have been going up and up. What this pricing pattern does is to encourage people to accept more credit cards and to charge more. Total U.S. credit card debt has been going up at a very rapid rate. It heavily penalizes debtors who fall behind, pay late, or only pay the minimum each month. For these debtors, interest rates quickly go up to 24 percent and 30 percent. This pricing pattern increases the riskiness of debtors’ consumption, since if something bad happens and debtors fall behind on their payments or make only the minimum payment, they get hit with these very high charges.

The result is that when debtors’ earnings are high, their borrowing costs are low, so consumption is high. But when earnings fall, borrowing costs rise steeply and consumption
falls. The credit card pricing pattern makes consumption more risky, which makes bankruptcy more valuable. But, the adoption of BAPCPA has made it more difficult for debtors to file for bankruptcy. That means that many debtors will delay filing, which means they are more likely to have their wages garnished, and they will pay the high credit card fees for longer. So the social cost of debt is likely to rise.

To conclude, I think that pre-BAPCPA bankruptcy law needed reforming. We needed an earnings limit for bankruptcy—there is no reason for millionaires to gain from filing for bankruptcy. But, the reforms hurt the wrong debtors, since they deter filings by non-opportunists rather than opportunists. Thank you.

Melyssa R. Barrett: Thank you so much. Now I would like to turn to Teresa Sullivan. Her materials and presentation can be found in the materials packet. Teresa?

Teresa Sullivan: Thank you and good morning. When Sam Gerdano called me and asked me about participating this morning, he gave me a particular task. He said, “Suppose that when Congress had passed BAPCPA, they had at the same time enacted a program of evaluation research to see if the bill was successful. What kinds of things should Congress have put in that evaluation plan, and then how would you know today whether or not it was successful?”
Well, that was an interesting challenge for me. Of course, it did not happen because in the compromise and back and forth that goes in forming any piece of legislation, the objectives of legislation sometimes get a bit cloudy, and evaluation research requires first of all that you understand what were the intended consequences. I have tried to infer from reading the transcripts of testimony, what those might be, but I do not pretend that I picked up all the nuances of it.

Also, we have to decide what is a reasonable indicator. In evaluation research, you obviously need a set of metrics. Those metrics need to have three characteristics. First of all, the metric has to be something that you can value. You need to be able to put a numerical figure on it. Secondly, it has to have a valence. That is, it has to go up or down so that you can see if there are differences over time.

And the third is, it needs a way to measure whether it is going in the right direction or going in the wrong direction. Having a valence alone is not enough. Many of the metrics that we have heard about BAPCPA fail on one of these three tests. For example just to pick up some random metrics. The law itself is 500 pages in length. That is a value but it does not have a valence and it does not have an interpretation. It meant a lot for those of you who to wade through the 500 pages in terms of your time, but it does not help us to evaluate it.
How about the fact that the US Trustee Program needed an additional $37.2 million? Well, you understood, certainly from hearing Mr. White’s discussion why they would need that money. That has a value. It has a valence. It is more money than they had before, but we cannot put much of an interpretation on it. Similarly, there were 40 to 50 new interim rules required a projected $241 million from an increase in filing fees, and a need for 28 additional judges and 320 additional staff at the Office of the US Trustee. Those have value, they have valence, but it is difficult to interpret those because those judges might have been needed anyway. Those are not, to start off with, things that I think we can use to evaluate it.

In addition, there were a number of tasks done during this past 12 months that are really not part of the evaluation but were very important to get done. For example, US Trustee’s Office had to find a way to proactively identify presumptively abusive bankruptcy cases. They had to develop a method for conducting the random audits, which, as you heard, will begin later on this month. There had to be an official form for incoming expense disclosure, something that had not previously been developed which also required the promulgation of appropriate median incomes and so on.

There had to be an arrangement for safeguarding personal information from disclosure, and maybe most difficult, there had to be a way to certify qualified credit counselors and debt
educators, something that the Office of the US Trustee had never before done. So these were important tasks, but it was an intermediate goal and not ultimately part of what we have considered to be evaluation.

What might be indicators of success or failure? That is, things that we could interpret based upon the law itself and some of the things that were said about the law at the time it was being considered? One thing that we heard was that the number of bankruptcy filings would drop, and that was definitely the case. Bankruptcy filings basically fell off a cliff after October of last year, and so although for the 12 months ending June 30th, there was actually a relatively small decline of 9.5 percent overall in filings. The actual decline from October to December was really a precipitous drop.

The drop in Chapter 7 and in Chapter 13 were both substantial. But one other thing that I think many people would have predicted based on the law, and which was perhaps the desired objective, was that there would be a shift in the number of people filing Chapter 13 relative to those filing Chapter 7. In June of `05, there were 65 Chapter 13’s filed for every 100 Chapter 7’s. By October, that number had increased. October of last year, when the law first went into effect. There were only 12 Chapter 13’s per hundred, so there was a substantial shift in the relative proportions of 13’s to 7’s.
Does that mean that the law was successful in doing this? Well, certainly if the goal was just a shift in the composition that was a success. The long-range interpretation of this probably will depend upon finding out how many of these Chapter 13’s are dismissed and what the eventual repayments are. Previous research has shown that about two-thirds of all Chapter 13’s do not make it to final discharge. So one indicator we would want to look at is whether these post-BAPCPA Chapter 13 filings make it through the discharge or not. It is really too soon to have an answer for that.

Another thing we might want to look at is whether the number of presumably abusive filings is down. Based on data offered by Mr. White for the Executive Office of the US Trustee, it appears that 95 percent of the bankruptcy cases that were filed were below the median income, and thus presumptively passed the means test. Of the remainder, relatively few were deemed to be abusive and in fact, less than one-half of one percent of all the cases was investigated for being presumptively abusive.

Another objective we might look for was whether credit counseling is successful. And again, this is one that does not lend itself to easy indicators, but there are few indicators that we could look at. The NFCC reports that of those who came in for credit counseling, only 3.2 percent took the debt management plan, which was an alternative to bankruptcy.
Indeed, the NFCC reports that most of those who came in for credit counseling were described as being in desperate shape, more likely than others who come in for counseling to have lost their jobs, to have lost income, to have medical reasons and divorce reasons for seeking the counseling, and ultimately seeking bankruptcy.

The Executive Office of the US Trustee reports that only about 10 percent of those who got certificates of credit counseling did not follow through with bankruptcy. Does that mean the credit counseling was successful or not? It is hard to tell. One interpretation of that could be that the people getting the credit counseling were already too late, needed the bankruptcy anyway, and so the credit counseling served only to add to the cost of bankruptcy.

Another interpretation could be that if you saved only 10 percent from going into bankruptcy, you had achieved less success. Let’s go on and look at some other somewhat more dubious hypotheses, which might or might not be considered as a success. Did the fees associated with filing bankruptcy rise? Certainly, the costs associated with filing bankruptcy rose, and that is a barrier to entering bankruptcy. The costs increased because of the credit counseling fees, even though those fees were waived for many low-income debtors.

In a survey released this month by NACBA, a quarter of the respondents said that the time they were spending on each
bankruptcy filing had increased by over 100 percent, and 92 percent of them felt that the changes in law had increased the cost but did not increase the results of bankruptcy. That suggests that although the cost of going into bankruptcy has increased, there may not be a real payoff to that other than the cost increase itself, which serves as a barrier.

Another indicator which might not be an indicator of success but might be a sign of the effect of the law is whether other alternatives to bankruptcy increased, such as defaults and foreclosures and so on. Market Watch reported that in the first quarter of this year, mortgage defaults were up 91 percent in Michigan, 39 percent in Ohio, 32 percent in Illinois and by the second quarter, they were up 67 percent in California.

Bankruptcy is not necessarily to blame for this because adjustable rate mortgages, many of which come due within the next 18 months, are more likely to be the immediate effect. But as an alternative to bankruptcy, this increase is certainly not paralleled by any gradual increase we have seen in filings during 2006.

Another possible indicator would be whether consumers are more or less confused about what their rights are in bankruptcy and about whether bankruptcy is even legal. Here, there is really only anecdotal evidence to go on. How consumers, in general, regard bankruptcy these days, what they know about
bankruptcy is really only a matter of speculation and not something on which we have any data.

So what kind of data would it have taken if Congress had wanted to really evaluate whether the law was successful or not? Most importantly, I think we need more data about the debtors who enter bankruptcy, and it is possible that eventually we will have data from the official form that will be more useful. It would also be useful to do a retrospective analysis of those who file for bankruptcy before the new law took effect and to see if those people had, for example, greater income going into bankruptcy than those who went in after the law.

Some earlier studies, including studies based on my own research and that by Michaela White whom you will hear from this afternoon, suggest that debtors filing for bankruptcy were already, for the most part, below the median income and that the number of bankruptcies that were presumptively abusive were always low. In that respect, the law did not make very much difference. It would also be useful for us to have some way to see a long range estimate of whether debtor education makes a difference. Longitudinal studies of debtors entering bankruptcy have been very difficult to do for a variety of reasons, including the fact that they are often geographically mobile and it is difficult to contact them.
But whether debtor education makes a difference in preventing these people from entering similar debt trouble later on, we just do not know, but that is something that would be a good long-range study to do. The debtor audits themselves may form another basis of information for us to get an idea about whether the quality of the data coming into the bankruptcy system has improved. It would be possible to do at least some retrospective audits of the schedules filed in bankruptcy before and after the law to see what kind of difference that has made. Certainly, we know the attorneys are spending more time on it according to their own survey.

Finally, I think that to fully study whether or not the law succeeded, more systematic data available on the credit industry, the creditors’ attorneys, the consumer debtor attorneys, and on the credit counseling agencies themselves, would be helpful. I think that today’s conference provides us a starting point for that, but not a particularly systematic starting point simply because of the difficulty we have had so far in pooling together the data.

Finally, I suggest that we ask the question. Does it make a difference if there is no evaluation plan? It probably does make a difference just because it makes that issue of interpretation so difficult for everybody. By picking and choosing among the various metrics that I have offered this morning, you can draw almost any conclusion, either that the
law succeeded or that it did not succeed. I think it will take probably more than the initial 12 months for us to reach a conclusion.

Melyssa R. Barrett: Thank you, Dr. Sullivan. At this time, the panel will take questions from the audience. Yes?

Male Voice: I wanted to address Professor White’s point about opportunistic debtors in the means test. I think opportunism will be successful only to the extent that the parties do not take advantage of section 707(b)(3), which allows for filing of an abuse motion even where the means test presumption is not a problem.

That, however, will require both diligence by the parties in interest and of knowing that some judges would find abuse where the means testing had been passed.

Michelle White: I certainly do not disagree with that, but I think that the information that the trustee and the judge has is what is going to be on these papers. And so, I think it must be inevitable that a large fraction of these kinds of situations go undetected. This is an empirical question that we would love to have some more information from, but it just seems impossible to catch them all.

Cliff White: May I also just respond to it briefly because Judge Wedoff is absolutely correct, although there are still some legal challenges there. I asked you if someone co-passes the means test and the implication of (b)(3), but our
position squarely is that we have filed a number of (b)(3) cases where a debtor passes the means test but still we find to be abusive and the new standard is abused, not substantial abuse.

As to the question of the information, we have even more information than we had before. So while you are correct, it will always be difficult to prove up abuse. There is always some limited information. The fact is we are better off today than we were 13 months ago in having the information to bring a (b)(3) and the standard for approval is now lower than it was before.

Michelle White: In effect, this becomes part of the opportunistic decision process because just like doing something a little bit shady on your taxes, there is a chance you might get caught and there is a penalty if you get caught and you take that into account in making your decision.

Male Voice: Professor White, I’m assuming that in the marketplace today, major credit card issuers have potentially lower interest rates and lower annual fees, which is what I would expect the competition to work. People with good credit will have more and more information about the cost of credit cards because of mandatory disclosures, I get to choose the card with the lowest fee and the lowest interest rate, but then there are higher penalties for being late with your payment, for being in the default on a number of cards.
You seem to draw the conclusion that this would encourage more borrowing and therefore, more bankruptcy, but one could just as easily conclude that the competition on rates and fees would actually lower bankruptcies because the consequences of starting to fall behind on your debt are more severe. So there is a disincentive to take on more debt than you can handle when you are going to fall behind and be late in your payments. Could you see that other people could draw other conclusions from the observations you have made?

Michelle White: Right. But, remember that I started off taking about one of the economic functions of bankruptcy, that it provides some consumption insurance so that if the combination of your income and your debt would really push your consumption down, that that can have high social costs and we would like to prevent those costs from happening.

The point that I was making is that this new pricing trend in credit cards has increased the riskiness of debtors’ consumptions. The high is better because you have got these zero annual fees and zero interest rates even for a long time. But the low is lower because when bad things happen and you do have debt, you pay much higher interest rates, much higher fees. I have done some calculations that basically say if you keep on paying the minimum, your debt just gets higher and higher. You never get out of it. So that the low is –
Cliff White: That is no longer true. Federal banking regulations now require a minimum payment where there is a negative amortization.

Michelle White: Okay, just barely. You are right. There has been a change. Now, it is a little bit positive. But you still will be paying for a very long time. The point is just that the risk that people face is now higher. That makes bankruptcy more valuable but it has become less available.

Melyssa R. Barrett: Go ahead, you had a question.

Male Voice: Just a followup on Judge Wedoff’s point, I am in the course of reading every 707(b) case ever written in, and my overwhelming impression of BAPCPA is that it has no impact on what the law was. If anything, as Professor White had said, the test seems to favor opportunism and that Judge Wedoff’s point is equally true, that 707(b) scheme gives the opportunity for the courts if they would take it to keep out these abusive debtors.

The other comment I have is that I think I heard at least one comment that below median debtors are not subject to the means test. But that is not my reading at all. Everyone is subject to the means test. As you fall below the median, you get this limited standing over the U.S. Trustee granting the motion.

And then there is this mysterious standard which I do not understand at all – 707(b)(7). Who knows what that means?
That may or may not be immunity at all, but I do not see the means test as limited to above the median people at all in Chapter 7 cases.

Melyssa R. Barrett: One of the panelists?

Cliff White: I’ll make a couple of comments. The median income really goes to the issue of the presumed abuse with regard to whether the courts will take advantage of the (b)(3) opportunity. U.S. Trustee intends to give them opportunities to take advantage of making (b)(3) determinations, but let me say, too, with regard to trying to measure the impact at this point the number of B3 cases, we are dealing with really a different kind of population in the 12 months after the general effective date of BAPCPA. Because roughly speaking, five percent of debtors are above the median income, it was about 15 percent above the median income prior to BAPCPA.

So any of the numbers that any of us are sharing here with actual experience under BAPCPA, we know that the debtor population is different today. And there could be a number of reasons for that. We had the huge bulge in the two weeks prior with 600,000 cases that were filed just two weeks prior; 750,000 in the month prior to the general effective date of BAPCPA. So we are not dealing with a “representative” debtor population.

Another reason is, not to go too far afield but to tie in with regard to less strident rhetoric and more thoughtful
analysis about BAPCPA. The provost mentioned the issue with regard to debtors being confused. It is reflected in our artificially low number of debtors who are now filing. The fact of the matter is that there was a lot of hysteria in the wake of BAPCPA and I would guess, I have no empirical data, a lot of debtors thought that the relief was foreclosed.

I have talked with consumer and creditor representatives about this and there seems to be a consensus among divergent constituencies, that there is a lot of misinformation out there. All of us, as bankruptcy professionals, can help debtors in the public if we make clear that bankruptcy relief has been and remains available for honest and needy debtors. But I think that some of the hysterical statements are not totally unrelated to the fact that a lot of people in need of relief may not know that that relief is still available.

Male Voice: I would like to clarify a couple of statistics I believe I heard. Dr. Sullivan, am I correct in believing I heard you say that about 10 percent of the people who had gone through DMP or non-DMP at the counseling agencies do not follow through with bankruptcy?

Teresa Sullivan: Of those who got certificates yes, these data are actually Mr. White’s.

Male Voice: Okay, so according to the stats we have so far, 10 percent have not gone through with the bankruptcy after
they got a certificate. Is that inclusive or exclusive of the, maybe additional three percent that went on a DMP?

Melyssa R. Barrett: Could you repeat the question as well, since he is not at the mic?

Teresa Sullivan: Yes, I’ll be happy to repeat the question, the question is about those who went through credit counseling and did not go to bankruptcy. Ten percent of those who were issued certificates have not filed for bankruptcy. They may yet, it is just that they have not yet filed. My understanding is that includes the 3.2 percent who decided to do a debt management plan instead.

Melyssa R. Barrett: With that, thank you very much. We appreciate all of your interest and the rest of the program will also address some of the macro overview as we move forward. So, I would like to thank our panelists for their wonderful presentations. And I will give you back to Judge Dow.

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Dennis R. Dow: While we are starting to get set up for the next panel, I want to make sure that you are aware of the fact that the materials that you received include some information that is not on the PowerPoint Presentations that you are going to be seeing. As a matter of fact, it also includes some information that was not prepared by our panelists. We went out and obtained some additional information, current information, research, and other things that we thought would be relevant to the topics that we are discussing and which are part of your materials. I would urge you to scour your materials for additional information that has not been provided or prepared by the panelists that we have and supplements the discussion and the record that we are having today.

One of those things also, the additional handout that was available at the desk up there - one of the things that you do have in your materials is a report from the National Foundation for Credit Counseling on consumer credit counseling under BAPCPA. The one in your bound materials is the sixth-month report prepared by the Foundation which provides data and
information on characteristics of people undergoing credit counseling for this first six months under BAPCPA. This new report is the one-year report and includes information for the first 11 months of experience under BAPCPA and just became available very recently, I think today. We are providing you with the most recent information, which is available in this area.

We are going to follow up now in some detail for the next hour on one of the issues that was discussed briefly during the last panel, and that is credit counseling. As I’m sure all of you are aware, the new legislation includes requirements for credit counseling and education in a couple of different areas. First, under BAPCPA, individual debtors who file for bankruptcy must generally undergo credit counseling within six months before they file for bankruptcy. Specifically, they must obtain a briefing within the 180-day period preceding the date of the filing of bankruptcy. We will talk a little bit about what that means during the panel, and must also complete a course in personal financial management as a prerequisite to obtaining a discharge in a bankruptcy case.

Among the issues that we are going to talk about during this panel are the resources available to provide the required credit counseling from a logistical perspective. Are they available from an economic perspective? Is the cost a barrier?
Are those costs waived in the cases of debtors who cannot afford it? Is it available from a legal perspective? Are the exigent circumstances exception or deferral of the requirement for credit counseling being interpreted by the courts in such a way as to make the requirement workable for debtors who have genuine emergencies?

Is credit counseling meaningful? Does it provide meaningful information to debtors? What about the outcomes that we are seeing in credit counseling? Have they deferred any significant number of filings? Are we seeing debt management plans being created? And finally, what data are being generated by credit counselors and what do they tell us about the profile of people seeking credit counseling and the people filing bankruptcy?

To moderate this panel and introduce his panelists is Travis Plunkett, who directs federal legislative and regulatory efforts for the Consumer Federation of America here in Washington, DC. The Consumer Federation of America is a nonprofit association, a three-horned organization that advances consumer interest through research, advocacy, and education. He will introduce his panelists. Travis.

Travis B. Plunkett: Good morning, everybody. We have an excellent panel to discuss at length the pre-filing credit counseling requirement and also to some extent, the debtor
education requirement. Let me just briefly introduce our panelists. You have their extensive biographies in your conference materials.

To my near right is Ivan Hand. Ivan is the President and CEO of Money Management International, which provides bankruptcy credit counseling and debtor education throughout the nation. MMI is the largest nonprofit provider of credit counseling in the nation. Next we have Henry Hobbs. Henry is the chief of the Credit Counseling Debtor Education Unit of the Executive Office for United States Trustees. Next we have Susan Keating, who is the president and CEO of the National Foundation for Credit Counseling. NFCC agencies have done the vast majority of the bankruptcy credit counseling that is occurring. And finally we have John Rao, staff attorney with the National Consumer Law Center, specializing in consumer credit and bankruptcy law.

What I have asked the panelists to do is respond to an initial question and they were going to run through four or five questions about implementation of this section that has come up since the law took effect, and then we will throw a question to the audience.

The initial question is very broad. I would like to know how consumers are fairing under the law. What are the key issues of concern looking forward? And the issue you just
heard about, is the law effective? Specifically, is the pre-filing credit counseling requirement effective? First up on this question to set the scene for you in terms of implementation is Henry Hobbs with the Executive Office for United States Trustees. Henry.

Henry G. Hobbs: Thanks, Travis. From our perspective, the Credit Counseling Law or the credit counseling provision of the law is about consumer empowerment. Consumers are now getting budget analysis information. They are confronting issues that lead to their situation. All these are requirements of the credit counseling session as set forth in the law. They are being advised of options and alternatives that they may or may not have gotten before. They are receiving debtor education on the back end of the process, the pre-discharge education.

From our standpoint, it is about consumer empowerment regardless of the reason that the individual arrives at the Credit Counseling Agency or regardless of the reason that they go to an attorney to represent them to file a bankruptcy. They are getting information about how to do a budget, about what their alternatives are. We think that that is very important.

In terms of trying to figure out what is the measure of effectiveness, I’m not sure that simply conversion into a debt management plan is the sole means of determining whether or not
this provision of the law was effective. I think to some extent it is about the knowledge of the consumer, about the individual making an informed choice on what they do.

I think it will be interesting to hear both from Ivan and Susan, to get some more direct information on what the individual consumers are saying to the agencies as they come in. It is important that consumers know their options before they file. I think from some of the comments, that was one of the concerns and the reasons for the change in the law was whether or not consumers were really being advised of all their alternatives.

I think from our review of the applications from the agencies that want to provide this, we are being, as Director White said, “pretty scrupulous” in reviewing these to make sure that the content of the sessions, at least as they represent it to us in their application, covers all of the things in the Bankruptcy Code provisions with respect to the budget analysis, discussion of financial circumstances, and giving them their options. To the best that we can tell, that is happening.

Now as Director White also mentioned, we just started doing our quality service reviews. These are audits and we started going out to the agencies. We are actually observing sessions. We are looking it at the records of the counseling agencies to determine whether or not, in fact, they are doing
what they are proposing to do when they submit an application to us. I think this will be particularly helpful, at least on a case-by-case basis, to determine whether or not the quality of the counseling is as it appears to be to us when the agencies represent that to us in the application process. Certainly, a lot of people have been going to credit counseling agencies. There have been over 850,000 certificates issued since January 9.

Now part of those is debtor education, about 270,000 of those are for debtor education, but well over about 600,000 of those are for credit counseling. It is far too early to tell if there is any difference between the number of certificates and the filing rates, but it does appear that there is some differential at this point between the number of certificates that can relate to a lot of different factors.

I’m not a statistician. I cannot tell you exactly what those mean, but there is some differential between the number of certificates. That might be anecdotal information, that there is a difference and that people may or may not be filing for bankruptcy but again, it is far too early to tell from that.

In the materials there is a chart that shows, at least over the past few months, the difference between certificates and the number of cases that have been filed. Again, I think
it is important that all bankruptcy professionals make certain that individuals are aware of the credit counseling requirement. I think that will go a long way toward making it a more effective provision of the bankruptcy law.

I think it is important when you look at the timing of the session; it is to be done six months before. But if someone comes in for credit counseling on the day of a foreclosure, it is hard to figure out how they are going to have all their options available to them if they do not come in sooner. I think it is important that really everyone on this panel here, and you, bankruptcy professionals, make everyone aware of that provision because the sooner they go for credit counseling, the more likely it is going to be effective for them.

Travis B. Plunkett: Why do we not move to the right, and we will have Susan Keating with the NFCC to give her assessment of how the law is working.

Susan C. Keating: Thank you, Travis. I really very much support Henry, your comments, and would say that really after a year’s experience, just under a year’s experience, the National Foundation for Credit Counseling really reports that we believe that we are, as a credit counseling organization and as agencies, meeting the mandate of the counseling and the education provisions of the new law. We also believe, however, that it is too early to really understand and to put sort of a
measure, relative measure of success on how the law is operating and the ultimate impact to consumers’ longer term. However, we do believe that things are going relatively well at this point.

In April of this year, the NFCC issued a report titled (Meeting the Mandate), which I understand you have a copy of. Additionally, we are just issuing a new report which takes the 11-month period into account through the end of August and basically, as was suggested by Travis, two-thirds of our agencies, including Ivan’s MMI, are part of the NFCC. Two-thirds of the agencies providing services are from the NFCC and providing the counseling and about a third of our agencies are providing pre-discharge education, and through August provided 560,000 sessions and over 630,000 certificates.

Now let me just briefly highlight some of the results of, and what we have learned about the impact to consumers. First is that consistent with our prior report, we are finding that consumers are very upside-down financially, and in fact, their unsecured debt exceeds their annual income, and in fact six-month period to now, that delta between the two has grown significantly which is suggesting that the client credit profile is deteriorating.

Also, we are seeing a greater prevalence of mortgage delinquency, and again there was some suggestion and reference
this morning to the fact that we have a large number of ARMS that are resetting. We think that that is problematic, and that is being evidenced in the input and data that we have received.

Also, the number one reason that the agencies are reporting that clients are considering filing for bankruptcy is the fact that they have been overspending, and that there in fact are poor money-management skills or habits and problems. That is coupled - the top three, as was reported earlier, top three is poor money-management along with medical problems and also loss of income. Those are clearly the top three. These consumers have some serious problems. Phone and Internet counseling continue to be the predominant mode of delivery.

Also, what we have learned is that interestingly, on a percentage basis with the pre-discharge education, there is a higher relationship of face-to-face delivery than on the pre-filing counseling. Also, one of the surprises was learning on a relative basis, how much longer it is taking to complete the pre-discharge education sessions via phone and Internet versus the face-to-face delivery of those education sessions. We have anecdotes of problems, just sort of accessing data, understanding, and some of those sorts of things, but we think that that is fairly significant.
Again, the impact to consumers in testing pre- and post-, we are learning that from about 10 to 40 percent of the knowledge base is increased at least in the short term. What we do not know is whether that retention will stick over the long term, and we think we need to do a lot more testing in that arena. And then again Travis, in terms of DMPs and alternative products, it is less than four percent and further. I’m hoping we will get into some discussion about the 60-60 settlement product that simply is not being utilized today and there are issues with that.

Finally, I guess my comment would be funding continues to be a problem. We are anticipating this year, even with reduced filings, that NFCC agencies will have about a $7.5M funding shortfall. But in conclusion, you will see in the report, our new focus is really around outcomes measurement and outcomes tracking. I think that will be critically important to really assessing the effectiveness of this new law. Thank you.

Travis B. Plunkett: Thank you, Susan. John.

John Rao: At the risk of being one of the individuals Cliff White may have referred to as not showing due respect to the new law, I would just say that I went into, as with many in consumer organizations, I went into last year with a view of being really a skeptic about the credit counseling provisions.
In my view at least back then, it appeared to be one more barrier for consumers to obtain bankruptcy relief, and more importantly it was an additional expense to consumers at a time when they are most financially and already financially in distress. There is no research or evidence suggesting that having these requirements just before someone is considering bankruptcy would have any effect in terms of trying to help consumers to avoid bankruptcy. There was no research showing that it would be effective. The view a year later, at least in my view, has not changed. I think that the vast majority of consumers in the NFCC report show this.

NACBA also came out with a survey of some of the agencies about six months after the bill had become effective, showing that the vast majority of consumers who are filing are essentially too far gone for there to be any viable alternatives, in that for the most part bankruptcy is the only or reasonable option available for the majority of people who are filing.

Now perhaps it is too early to tell but I think what is really interesting about what Susan just mentioned is that their most recent report is actually showing the indicators about folks who are filing and why they are filing, it is actually showing that as filings are now increasing, the financial condition of those filing, as Susan said, has
deteriorated. I think we are going to continue to see that
that is the case.

Now why is it true and why is this perhaps not being
effective? I think there are three main reasons. One is, of
course, the timing. I think everyone in the bankruptcy
community can certainly acknowledge this. Having someone go to
counseling at a point where they have made a decision or they
are considering filing bankruptcy is just too late. If this
requirement or the counseling or education component of it were
to be effective, you need to start much sooner. In fact, the
mandate really should be for some kind of financial education
courses in high schools, before students graduate from high
school; that would clearly be a much more effective way to help
consumers avoid bankruptcy.

Timing is clearly a major issue, but the other issue is
that it is not clear that there are real meaningful
opportunities in counseling for someone who is in that
position. Now, my organization, NCLC, has always been
supportive of credit counseling if it is done properly, if it
is properly administered by legitimate nonprofit organizations
that offer a range of services. The problem is that for
someone who is considering bankruptcy, they need something more
than the traditional DMP model that is there now. There are no
significant meaningful concessions that are being offered as part of these plans.

What the consumer needs is some debt principal reduction. That is the only way this is going to work. And in fact, it appears, as Susan mentioned, that Congress was actually looking for this when they adopted Section 502(k) of the bill which talks about 60 percent plans or reductions of principal of approximately 60 percent. Without that and it is not happening, going to a credit counselor is not going to have any effect.

Finally, the third issue is that until there is some really effective regulation of some of the more significant or severe predatory lending practices, consumers are still going to be in this position of facing a debt load that is just too hard for them to deal with. There has been a lot of discussion about some of the positive benefits, and I would say that even the agencies would admit that most of those go to the education component of the counseling requirement, not the alternative or other options available. My position on that is there may be some benefits to the education component, we do not know. I think that there is - but it can be provided and is being provided as part of the financial education component for pre-discharge. There does not need to be this requirement pre-petition.
Finally, just a couple of quick things in terms of recommendations if I were to propose what needs to happen, I think to make this work better, I think one thing is that there should be an elimination of the pre-credit counseling requirement in Chapter 13 cases if the debtor can certify that their reason filing is primarily to deal with secured debt or tax debts or some priority debts which are not really going to be dealt with by credit counseling in the DMP model or any other alternatives that they may be providing. But if there is a foreclosure or repossession, and that is the primary reason for them to file the 13, it should not be a requirement.

There should also be an expedited procedure or briefing requirement for debtors whose income is so low that they cannot even meet the basic necessities. And again, the counseling requirement, the education part of it can still be there but that would be dealt with later after the filing, in that debtors who are having problems in Chapter 7’s with things like foreclosures would also be eligible for this expedited briefing.

Travis B. Plunkett: Thank you, John. Let me turn it over to Ivan now.

Ivan Hand: Thank you. I would just like to respond to a couple of points that the panel has made so far. First is on the value of the counseling itself, the educational value. I
do not want to undersell that. I think that is very important. We surveyed 6,000 counseled clients recently and there was significant knowledge gain relative to some very basic financial concepts, like goal-setting, secured versus unsecured debt, fixed and variable expenses, things that these people did not know before they walked in the door. But you have to remember, this is the first time many of them have ever talked to a credit counselor. For the first time, they have now gone through their budget and their finances, and their expenses, so the knowledge gained there is very, very important.

The other thing that they reported, in the survey, is they have a high likelihood of changing their behavior in the future. They agreed to track income and expenses, reduce spending, cutting unnecessary expenses. I do not want to undersell the fact that the debtor is getting some valuable information through the counseling session. There are not as many going into alternative options like debt management plans, but I think that, as the panel has mentioned, that is in large degree due to the timing of when they come to see us. Ninety-two percent of all of the debtors that see us have already retained an attorney. They have already paid fees. Seventy-eight percent of them have paid the vast majority of the fees; almost half of them have paid all of their fees. Once the debtor has paid the attorney’s fees, they are so far into the
process that it is really hard for them to evaluate any other options.

We need to talk about the timing of counseling at some point. We also need to identify some other products that could be available, such as less than full balance debt management plans. But at the same time, let’s not forget about the education value in the counseling session.

Travis B. Plunkett: Okay. We are going to revisit a number of the issues that have come up in greater depth. The next item, I would like to ask John Rao to start with this, and I know Henry will want to talk about it as well, to assess the case law that has occurred and evaluate the impact of this requirement on the court system itself.

John Rao: I think that what we have seen in the first year is the courts had to deal - the biggest problem, I think, is the unrepresented debtor, the pro se debtor, who has filed, and may not be aware of the new counseling requirements and most importantly was not aware of what needs to be done to try to obtain a deferral or waiver of the requirement if the briefing was not done before filing. At least initially, there were a fair number of cases involving what is required to obtain a deferral of the counseling requirement until after the petition has been filed and whether or not there has been a proper showing of exigent circumstances. The new law does not
define exigent circumstance and the courts, of course, were faced with trying to come up with a meaning.

I think at this point, we are seeing some different opinions about that, and I think to some extent they are a bit troubling and most of the decisions have found, for example, that a consumer facing a foreclosure would be sufficient to establish that there is an emergency, that there is an exigent circumstance. But some courts have looked at the issue of whether or not, for example, the debtor has basically had their head in the sand. Have they waited too long, did they get notice of the foreclosure, or did they wait till the last minute?

While I can appreciate that, I think it also is important to understand that consumers do not want generally or are not interested in racing off to file bankruptcy, and they will often wait until the last minute, hoping that something else will happen. There are factors, too, and the problem with these cases is that most of them were pro se debtors, and maybe were not doing a good job at really telling the court what was going on, whether they were still working with a mortgage lender, for example, on a workout and did not find out until the very last minute that the workout had fallen through. These are some issues.
I think another real problem that the courts have faced is the issue of the pro se or the debtor who does not satisfy the requirement, did not meet the mandate for deferral, and the case is dismissed. How should it be dismissed? Should it be stricken, as some courts have said, or should it be dismissed? Of course, the implications of that will lead to other provisions of the act which are, whether or not the debtor would get an automatic stay or would only get a temporary automatic stay if they were to re-file a new case. Courts have struggled with that issue and we are seeing opinions about that.

There have also been some problems and concerns about the precise wording of the statute when it says in Section 109(h) that the requirement needs to be obtained during the 180-day period preceding the date of the filing of petitions. Some courts have said that the way it is worded suggests that Congress really meant that there should be at least a one-day waiting period that you can not have counseling on the day of filing. There have been a few decisions that have said that. I think the United States Trustee’s position has been that that is not the interpretation of the Act as they see it, nevertheless, it has resulted in some cases being dismissed for that reason.
I should say that the Rules Committee has worked hard in trying to deal with some of these issues, at least with making sure that pro se debtors are aware of the requirement. And I think that the new Exhibit D to the Petition which is being implemented will hopefully be a positive step to at least, it does include a warning, particularly unrepresented debtors would see, which hopefully will advise them about what they need to do and perhaps would not file the petition without having obtained counseling. So hopefully that new form will be helpful and we will just have to see how that works out going forward.

Travis B. Plunkett: Henry.

Henry G. Hobbs: John, I would agree with you with respect to exhibit D which Judge Wedoff had tremendous input on, and I think it would be particularly helpful for pro se debtors and for all debtors, really, to advise them of the consequences if they do not receive credit counseling. It has certainly been the position of the US Trustee nationally to exercise some prosecutorial discretion with respect to pro se debtors and debtors in extreme circumstances going forward. And as you pointed out, some courts have interpreted the provision literally such as you cannot get it on the day up. Do you see, from your standpoint, in the cases that are being filed that courts are still interpreting it literally?
John Rao: There is a fairly recent decision that came out to that effect, but I have not heard of it being a big problem and it probably will not be if your office is not pushing the issue, so we will just have to see how that works out.

Henry G. Hobbs: I think in terms of the strike versus dismiss issue, I think the majority view is probably dismissal. I certainly understand some courts have fashioned a remedy when they have seen the situations that you laid out, John, where you had a pro se debtor who did not really know what the requirement was and it was the situation where the automatic stay was important, but there is an alternative that a debtor and individual has in the event. It is not an automatic thing. They cannot seek relief from the stay if their case gets dismissed as a result of that.

John Rao: Yes. Again, the problem is if that debtor continues to be unrepresented, they may not know how to proceed to obtain the extension of the stay in the new case. But I agree that probably the better way to approach this is, that really the cases ought to be dismissed, and I think that the debtor in the new case would be able to show that the new case is filed in good faith if the only reason that the prior case was dismissed was if they were unaware of the counseling requirement.

Henry G. Hobbs: That makes sense to me as well.
Travis B. Plunkett: Okay. Let us delve into the fee-and-waiver situation a little more thoroughly. You know the statute requires that fees that are charged be reasonable without regard to the ability of the debtor to pay. I’m going to ask Susan to address this first and then others on the panel. The NFCC says that they are not covering their cost for their agencies given these requirements. They also report them in the 11-month update that Susan just mentioned that NFCC agencies are offering 16 percent of their counseled clients’ waivers.

I would like to ask Susan to address this issue, and then John and Ivan and anybody who wants to. Is this system working? Are people who truly cannot afford counseling getting a waiver, and are the fees that are being charged reasonable for both the consumers and the agencies?

Susan C. Keating: Travis, thank you very much. First of all, I want to be clear here. The agencies that are delivering these services are nonprofit agencies, and by members’ standard and also, as Travis just mentioned from a regulatory statute perspective, we offer services to all clients whether or not they are able to pay. It is not that we offer 16 percent waivers. We offer and provide services, and if a consumer or that family is not and does not have the ability to pay, we waive that fee.
Now in fact, it was interesting and John, as you were talking, I seriously wanted to get into a debate. I was holding myself back. As John said, we have one or some - John would suggest that we have added additional burdens of cost to consumers and to these consumers considering filing for bankruptcy. I just would submit to all of you here that if the average fee for counseling in the guideline on the part of our EOUST is $50, it is not the $50 that is creating the significant additional cost burden. And again, if that consumer is not able to pay, we waive the cost for that service. Now the impact is such that we are not covering the cost.

Some of you might suggest that if agencies in general are not covering their cost, why are they not applying to EOUST to increase their fees to the clients? I would just say to all of you that that really opens another trapdoor, that in fact if we are seeing 16 percent waivers to date, by increasing those fees we will probably have fewer clients able to pay, and it kind of goes round and round, so I’m not sure that that would dig us out of the hole that we are talking about here.

I would just say finally without belaboring the issue of the cost of delivery and the fact that we are running with a funding short fall, I think the real burden here is longer term if in fact the filings increased, we have got some decisions to
make and we believe that agencies will begin withdrawing and pulling out of providing the services if we do not address that.

Ivan Hand: Can I tag on to that?

Travis B. Plunkett: Yes. I have an issue - go forward. Let me ask you to deal with one sub-issue here. I have heard from some that although smaller agencies may not be able to cover their cost, larger agencies like yours with better economies of scale maybe. So if you could address that.

Ivan Hand: Okay. First on the fee structure, I totally agree with Susan that on the face of it, $50 sounds reasonable and I do not think it is the real reason debtors are seeing such large increases in the cost to file. In our case, our average fee that we collect from a debtor is around $35. We are waiving the fee in a significant number of cases.

Interestingly, we do not have a lot of complaints from consumers on the fee structure. For those that cannot afford it, do not have the ability to pay the fee, then we waive it, as I said, and others typically pay the fee. I will now speak to your point on the large versus the small. I think this has really been a transition year for all agencies. If you think about it, coming into the year, we did not know what the demand was going to be for the numbers of bankruptcies. We have no
idea how many filers, how many debtors, how many certificates were going to be issued.

On the other side of the coin, on the supply side, we did not know how many agencies would be approved by the EOUST. We are in an environment where you do not know demand or supply, and you are trying to staff up accordingly. Now certainly, some of the agencies, probably more so in the small than large, suffered with that because you could have too many people and of course not cover the cost of staff when the demand was not quite what you though it was going to be, and we struggle with that as well.

Earlier in the year, we thought that the demand, the filings, would increase certainly more than they have and we had more people than we needed. We had to pare down a little. But I think as we work our way through the system, as we get more to a steady state, more of a predictable environment, that we will be okay, that things will working themselves out. I also believe that there may be some agencies that will come back to the EOUST and will ask for increases in the fees that they are charging.

Travis B. Plunkett: Well, in fact they already have, Ivan, in some circumstances. And just to continue to throw statistics at you, just some very preliminary data that we have collected from agencies who have reapplied. They fit fairly
well with the numbers that Susan mentioned, about 14 percent, it looks like fees are being waived, but I think it is also important to point out that another 10.5 percent, the fee is reduced. You have about 75-76 percent of the consumers who are actually paying the full fee, and the full fee is around $50. You could understand the tension there, both between of the consumer and agencies’ ability to do the work and provide the service.

But I think it is important to mention the reduced fees as well because agencies do reduce fees depending on the circumstances, as well as waive the fees. This is something that Cliff White mentioned that the fee waivers, that is one of things we will more than likely address and propose rule-making later in the year because we had not set a specific standard with respect to fee waivers. Each particular agency would have its own fee waiver policies so the individuals may not know, and there might be a lack of consistency there. That is something that we are going to look at and we did receive some comments on our interim rule with respect to that issue as well.

Travis B. Plunkett: John.

John Rao: I would just say, especially for the lowest income debtors, the $50 for the credit counseling fee, when added together with the increase in filing fees, and even if
there is a private attorney involved who is perhaps even doing it maybe at a reduced cost, and when you add in the $50 for the education cost, this can be prohibitive for some consumers. I think it is very important that the United States Trustee’s office really monitor this as we go forward.

I do not know if 16 or 14 percent is the right number. I mean one thing that concerns me is initially there were agencies who were reporting, I think, higher numbers of waivers and they seem to be going down, and perhaps as there is more concern about cost factors. What will happen in the future? So I do think we need to monitor this.

The other factor is that the $50 fee, as was just mentioned, may not stay there, it may go higher. And so, this is something that we have asked the United States Trustee office to issue some pretty clear guidelines about what is a reasonable fee. I understand that they may not want to set a particular dollar amount, but something that gives more guidance about what is reasonable.

As to the procedure for obtaining a waiver, I have actually gone on some of the websites of some of the counseling agencies and tried to figure out how you obtain a waiver. Generally speaking, you cannot do it on the Internet. That may be reasonable but the point is, there are few agencies which have imposed - in an emergency situation this can be a real
problem, that have an imposed requirements that the individual contact the agency and then submit verification forms.

And for $50, and if there is a foreclosure looming, I just do not think it is going to happen. So, there needs to be clear guidance about fee waivers, and also the fee structure. Some of the websites are very good at this, others, you really have to click on these very small boxes to find out what the fees even are. I think that this needs to be addressed more carefully in regulations going forward.

Travis B. Plunkett: Okay, let’s pick up on Ivan’s reference to the fact that most people seeking counseling have already retained an attorney and talk about the role of debtor’s attorneys. I have heard from some creditors, that the fact that attorneys now in some cases are referring large numbers of clients to particular agencies and in some cases are paying on their behalf the fee that they think that may represent a potential conflict of interest. I have heard other concerns as well.

Ivan, if you could just talk for starters about this relationship from your point of view, from the point of view of somebody providing counseling, then we will ask the other panelists to discuss it as well.

Ivan Hand: Well, initially, we had cases of attorneys sitting in on counseling sessions, particularly over the
telephone. I think they were concerned that we would be trying to talk the debtor out of filing for bankruptcy. They were very active in the initial process.

That has stopped over time, because, I think as Susan mentioned, the number of debtors that are choosing debt management plans as an option is very small. So I think the attorneys are more comfortable that the agencies are providing the options and the counseling to the consumer without making recommendations that they not file for bankruptcy, but the attorneys are still very much involved.

It stands to reason they would be since, as I mentioned earlier, over 90 percent of the debtors are seeing the attorneys first. So, the attorneys in many cases are controlling the timing of when the debtor seeks credit counseling. They are controlling, as Travis mentioned, the agency that the debtor goes to. I think a lot of that has to do with the attorney’s experience with the agencies. They may feel comfortable that the agency is going to provide service on a timely basis, and that they feel comfortable with the quality of counseling that they are providing.

We do not have the payment issues that you talked about, so I really cannot comment on that one.

Travis B. Plunkett: Ivan, do you think there is any chilling effect by the attorneys either directing the client to
a particular agency or listening in or being more involved with the process?

Ivan Hand: Well, I think for the listening in part, probably so. I do not think it is necessarily chilling when they are just referring a debtor to an agency for bankruptcy counseling. It could be, obviously, but I do not see that a lot right now.

Travis B. Plunkett: So you do not think the agency has any fear of representing an alternative other than go back to that same attorney and file the bankruptcy case?

Ivan Hand: We do not. We have attorneys that refer to us occasionally but we go through the exact same counseling process, the exact same processes that we would do whether the person was in person, Internet, whether they were referred by an attorney, or whether they were not.

Susan C. Keating: I would actually jump in, though, Henry and say that, however, it really would be in the best interest of these consumers to have the session with an EOUST approve the agency before going to the attorney’s office, if in fact the pre-filing counseling is about informed consent, which is in fact what we understand that pre-filing component to be about and exploring options.

One other point that I would just make is that this notion of a low percentage of consumers enrolling for debt management
plans, again I just have to say, that is not the primary success of determining whether or not all of these is successful and so forth.

We really believe that the counseling and education is about addressing the problems of financial literacy which are coming out to be very significant and reported in our report. It represents the majority of consumers that are coming in and this is a teachable moment to get to these clients and again, inform them of the alternatives and then later through the pre-discharge education, drill in to a higher and a more intense level of education process.

John Rao: I think on the issue of the timing and what Susan just mentioned about having the counseling session before meeting with the attorney, the problem is it is just not practical. In my experience in representing debtors in bankruptcy, the reality is that they often go to see a consumer attorney because they are facing some imminent creditor action. It is either a foreclosure or a wage garnishment or some kind of action. Once the consumer meets with the attorney, the attorney obviously has an obligation to try to represent that client effectively and to stop that creditor action.

The other sort of significant factor about, and I think Ivan mentioned, the issue about many of the consumers have already been retained by the attorneys, you need to look to
other provisions of the Act. The debt relief agency provisions which were imposed upon attorneys require essentially that this retainer agreement be entered into shortly after bankruptcy advice is provided. I do not think it is the attorneys that can be blamed for that.

This is what the law requires. Congress has said that the process of entering into a retainer agreement needs to occur quickly before that legal - or at the time shortly after legal advice is provided. So if there are concerns about this, I do not know that they are easily addressed by the legislation as it is being provided.

The other thing is in terms of the listening in by attorneys, which Henry spoke about earlier. I think that some of that was going on at the beginning and legitimately, I think a lot of debtors’ attorneys were concerned about just what is happening at these sessions. They were curious and also very interested. There were reports of some bad legal advice being given out by counseling agencies. In fact, some of that even appeared on websites of some of the agencies and there was a legitimate concern about what was being said.

As time has gone on, that is not occurring at this point, perhaps on occasion but for the most part, the attorneys really do not have time in their day to be participating in these
sessions as they are going on. But there was concern initially, and I think for good reason.

Travis B. Plunkett: I have a follow-up question for Henry. Given your point on the chilling effect, my question is what could be chilled? Given what we have heard from Susan’s organization about the fairly small number of people who are enrolling in DMPs, from your point of view, from the point of view of a regulator, given the financial condition of those who are filing, and the fairly low number who are enrolling in DMPs already, are you concerned that somehow all these factors taken together might chill that already low number?

Henry G. Hobbs: My concern, the reason I addressed the question to Ivan from an agency’s perspective is that if there is a relationship where they are as a referral relationship, and assuming there is not some prohibitive referral fee or something like that but just as a matter routine they were referred to that particular agency, is the agency concerned? Well, if I in fact do recommend an alternative, whether it is a debt management plan or some other method other than filing for bankruptcy, is that attorney going to stop sending clients to me because they may potentially lose that individual as a client at least on an immediate basis?

I’m putting that out there for the agencies, whether that is an issue or not. There are alternatives other than a debt
management plan. Understand there is a low percentage but in those particular cases, it may be appropriate for an individual. It may be appropriate for them to go to family members to help them out with something rather than enter into a debt management plan.

If an attorney has made the referral to a particular agency, and they even have some sort of a relationship where they make the payment on behalf of their client, is that going to cause a problem for the agency or are they going to remain objective and independent and do what they say they are going to do?

I think that was the point. I was trying to get Ivan to say that is in fact what they would do and we will hold them to that.

John Rao: Henry, could I ask, I mean really, what are these other alternatives? You mentioned going to a family member. I think most debtors probably have done that before they have considered bankruptcy if they could, if that was a viable option. I’m really curious about what are these other alternatives. I just do not see, again, for someone who meets the profile of what the agencies are now seeing, someone who is essentially hopelessly insolvent, what are the alternatives? I just do not think they are out there.
Henry G. Hobbs: Well, if you start with the premise that they are hopelessly insolvent, then it will be hard for me to answer that question.

John Rao: You are absolutely right, but is that not what the agencies are seeing, that by their own statistics, their own reports, what they are seeing are debtors who are completely underwater? Their income is not sufficient to support their debt load. Maybe I’m answering the question for you. I think it is not reasonable to hold out this view that there are these elusive options out there that I just do not know about. That is the real concern.

Susan mentions the educational benefits and again, I do not deny that. You have mentioned those. I do not deny that those might exist. But, again, those can be dealt within the post-petition financial education course. I think that is probably more appropriately, where they should be dealt with. So I guess I’m just not sure about the options.

Susan C. Keating: I’m having fun being in between the two. No, what I would actually say that what you are really suggesting, John, is that there is only a legal solution. And again, our point, we are social services agencies, if in fact we are able to help consumers find an alternative, whether that is through family members, some sort of self-remediation, a debt management plan, or this other product that we have yet to
get live and get both creditor and regulatory agreement around, we feel that probably is in the best interest of American consumers.

And again, I’ll still go back and thank you for supporting the education piece. These people, these consumers, are American consumers coming in for the most part, as Ivan was describing with some of his results. They do not understand even some of the basics of financial management. And again we would love to see them sooner. There is no mechanism in place to have that happen today and we believe that this is a teachable moment.

Travis B. Plunkett: I’m going to be an intrusive moderator here because we would be remiss if we did not at least finish up with one final question on the debtor education, the pre-discharge requirement. John mentioned that this requirement has been less controversial. That is true, but not totally uncontroversial.

Forbes Magazine recently ran a piece on it contending that the advice that was offered in these courses was rather obvious, including that, “It is hard to say if it is working, but a bunch of people who are in bankruptcy are making a lot of money off it.” I’ll throw this one to Henry first, and let us hear the comments of folks on the debtor educator requirement.
Henry G. Hobbs: Well, one of the things that we have required of those providers that give the debtor education courses is that upon re-application, they provide us with the summary of evaluations because we do require that they get evaluations from the debtor students that go through the course. And at least based on those summaries of evaluations, the overwhelming majority of the individuals have indicated that they have learned something useful, they learned something that they did not know, and they learned something that they could use in the future going forward.

We would look at these percentages; I’m talking about a majority. It is not 55 percent. It is like 90, 95, 98 percent of the debtor students responding on these evaluations indicate that they are learning something from this process. So if that is the goal, and I think we probably can agree that that is the goal, the education’s goal. It seems to be happening, at least based upon that information that we are getting.

Ivan, do you have that experience?

Ivan Hand: I agree with you. The debtor’s attitude is different in the education sessions. They are more relaxed. They are eager to learn, participate. We constantly get compliments on the education programs that we have. Maybe it is that they are hearing for the second or third or fourth time how important it is to budget and track expenses and do some of
the basic things, but it seems to be sinking in. There is a better learning experience there so I’m a supporter of that provision. You made a comment about people making money off of it. Well, in our case, we waive fees just exactly the way we do with the pre-filing counseling. So for us, it is $30 to $35 for the two, two-and-a-half-hour session and that seems reasonable to me on the face of it.

Henry G. Hobbs: And the percentages there are similar on the data we have collected, preliminary data. It is the same sort of number on both the debtor education and the credit counseling.

Travis B. Plunkett: Susan or John, any thoughts?

Susan C. Keating: Yes, I actually do have some final thoughts. I actually think that we are earlier in the process with the pre-discharge education, just in the timing of this being the first year. And as Ivan has suggested, we are seeing from test results some knowledge improvement and we are getting feedback from clients that the sessions are beneficial, but I think the real true test for all of us is whether or not this knowledge base and this information and education sticks over the longer term.

In that regard, the NFCC recently announced the formation of a measurement and outcomes task force that is really going to look at different ways that we can consistently measure
outcomes, whether it is around attitude, behavior, knowledge, or some of the more traditional measurements of improved credit score, FICO score, and that sort of thing longer term. So we are going to try to get our arms around this and see whether in fact we are seeing a change over the long term because is that not what this is all about?

John Rao: I think going forward, this really calls out for some really quality academic research to see, and really to look at the effectiveness of these programs. I’m glad that the NFCC and other consumer counseling agencies are on their own doing some evaluation of this. I think it is very important. Another issue is that the legislation itself does provide for a pilot, and interestingly, it is a pilot even though it has already been implemented nationwide for everyone, but at least there will be these pilot programs where there will be some component about evaluation as part of that and I think that we need to really look at those results. I mean the real test on this will be to look at some of these debtors two years after and see where they are and what effect the education has had on them, if it has had any at all.

The only other concern is that I think it is important that as more providers are being approved, I think that it is important that there will probably be some... there is already some essential framework for what the course should be that the
United States Trustees office has set. I think it is important that the actual content of it be constantly evaluated to ensure that it is of top quality. And perhaps maybe, there should be some consensus about really what kind of information should be provided.

I have looked at some of the course materials. I have had some concerns about some of the information that is being conveyed. Other information is really quite good, but there are some that does concern me, especially when it talks about some of the consumer rights and so forth. I think we need to look at this going forward and try to make this works as best as possible. And the debtor education pilot has been going on most of this year. We will continue that in six judicial districts until probably the end of December and then put out a report next year on the debtor ed pilot.

One other thing I would say is that it would probably be most effective if it really was given in person, and I realize this has problems for some debtors to actually do this. But if it was probably due right after the section 341 meeting when the debtor was there, and I know logistically this would be problem for the agencies no doubt. But if it was in person right in the same building where the section 341 meeting is and if it included - these would most likely be group sessions - some one-on-one component with the individual consumers, I
think it would be most effective and it would be easier for the debtors. I know some Chapter 13 trustees have been doing this, and I think that is really the way, probably the best model for this to be effective.

Travis B. Plunkett: Any concluding thoughts on this, Ivan?

Ivan Hand: Just one last quick thought. I mentioned early on that we had surveyed some 6,000 debtors that had gone through both our initial counseling session. We surveyed them pre- and post-counseling and 98 percent of them said that if they ever got in financial trouble again, they would seek credit counseling first. I do not know how you would ever just put a numerical value on that, but it seems to tell me that they must see some value in it. I do not know how you measure it, but it seems to be valuable.

Travis B. Plunkett: We are out of time. I’m looking at our host here to see if we should ask a question or two, ask the audience to throw a question or two, or whether we should conclude this session.

Okay one or two questions. Yes, sir.

Male Voice: I have a question that is probably directed towards Henry. I do a fair amount of debtor work. I do some legal aid work as well as represent the debtor client. Initially, when the credit counseling came on, I heard reports
of some inaccurate information. At that time, I think agencies were getting ramped up and maybe perhaps have some new counselors on the staff.

I really have not heard much until very recently, and I was quite surprised just during the last month, I have had two clients. One told me that the counselor told her that her name was going to be in the paper and another one said she is going to lose her house. I now had to explain to them, “No, that is not going to happen.”

Henry G. Hobbs: If they are providing false information or inaccurate information from that standpoint, well, certainly one of the things that is in the materials is our e-mail complaint address so that something like that, we want to investigate the quality of the counseling that is being given and to the extent that there are misrepresentations that are being made.

We want to see that because that is something we would want to consider on reapplication of those agencies because they have to reapply every year after the first six-month probationary period. We would certainly want to look into that and see if it is prevalent, if it is a counselor that needs retraining, or if it is so extreme, then it is something where we would revoke the approval of the agency because they are consistently giving bad information. So at least from a
regulatory standpoint, that is something we would want to know about and I would urge you if you had those sort of complaints or sort of issues, to use that e-mail address so that we can know that that is going on and take action.

The view of the United States Trustee’s Office has also been very clear that the agencies are not to provide legal advice, and there is a provision of the code that sets a private right of action against the agencies for any violations of any of the provisions of Title 11.

Travis B. Plunkett: One more question. Anybody?

Male Voice: I have a question for Henry. Henry, I do not know if you are able to give us any indication about whether the EOUST and the new regulation that is coming out later this year will be able to address either any of the attorney practices that were discussed today, or whether it has authority under the law. I want to put that question in context.

The American Bar Association, which was strongly opposed to some of the provisions of the law which affect practicing bankruptcy attorneys, nonetheless just adopted a resolution this August which they conveyed to the Advisory Committee on Bankruptcy Rules in which the American Bar Association said that there is such a significant problem of inadequate and misrepresentation of clients by some debtor attorneys,
particularly those with high-volume Chapter 7 practices that they asked the rules committee to look at developing new sanctions because they said the existing judicial code sanctions were inadequate to curb this unacceptable type of counsel behavior.

So I think I do not want to tear all the debtor attorneys, but the leading attorney group in this country just said there is such a significant problem that new sanctions need to be developed.

Henry G. Hobbs: Well, certainly we are not going to set forth any sanctions generally on attorneys, but in terms of in the credit counseling context we are looking at certain practices. For example, there had been very remote and isolated reports of attorneys who are actually on the Internet and attempting to take the course for a particular debtor.

Well, that is not counseling. I think it is a misrepresentation that the consumer obtained a certificate for taking a course, the consumer did not take the course, the attorney took the course. So in instances like that, we will certainly contemplate addressing that. But at this point, I cannot indicate exactly what that provision would be, but we are trying to make sure that there is some integrity to the process so that the consumer is able to get actual counseling
as opposed to just continuing to be part of the attorney
preparing the papers in order to file the bankruptcy.

Dennis R. Dow: Well, I want to thank the panel for their
presentation. We are going to take about approximately a 10-
minute break and reconvene at 11:00 and change the focus, and
talk about business bankruptcy.

[End of file]
Judge Dow: One question is whether the passing of BAPCPA has attributed to the decrease in business bankruptcy filings and whether this trend is likely to continue. Of particular relevance are the perceptions that BAPCPA may have increased the cost of Chapter 11 reorganizations. Several changes may have had this effect, including changes which increase cash requirements for debtors, like the treatment of utilities and new administrative priorities for suppliers of goods to the debtor. This panel will also discuss whether the specter of increased cost has caused some companies to consider alternatives for resolving issues of financial distress. Our moderator is Ricardo Kilpatrick. Ricardo is the president of Kilpatrick & Associates in Auburn Hills, Michigan and is a past president of the American Bankruptcy Institute.

Ricardo Kilpatrick: Thank you. As indicated, we are going to take the next hour or so to discuss the effects of BAPCPA on the business cases. The way that we have structured the presentation is that we are going to talk a little bit about the pre-bankruptcy era, and, what is different now as compared to what occurred prior to the amendments. Judge
Perris is going to discuss statistics and will give you an overview of the program. Lisa Donahue and Susan Freeman are going to discuss the actual operation of some of the provisions that Judge Dow just indicated. Stuart Gold and Judge Perris are going to discuss the individual and small business cases.

Since I have given you their names, I better introduce the players. To my left is Susan Freeman with Lewis and Roca in Phoenix. She is a very seasoned practitioner, and does a lot of committee work in major Chapter 11 cases. To the far right is Lisa Donahue. She is the manager of the Restructuring Group for the workout firm of Alix Partners in New York. Judge Elizabeth Perris sits in Portland, Oregon is very active in many of the educational discussions for the judges themselves. And Stuart Gold to my right is also a practitioner in Detroit. He is with Gold Lange & Majoros and is one of the few practitioners nationally who does both very sophisticated consumer work and does a lot of small business cases so he is right there in the trenches. To the panel, I would ask you, has anything changed in the pre-filing world as a result of BAPCPA?

Lisa Donahue: Well, what we are seeing more of on the pre-side and we should preface this with as we start getting into some of the discussions because it is only a year and some of the bigger issues of exclusivity et cetera, we do not really
know yet what the effect is going to be. We can talk a little bit about some of the larger cases and some of the pre-planning that has to go. Ricardo had mentioned utilities and reclamation cost, so DIP-sizing is of particular concern now.

More cash is needed upfront than before so sizing the DIP appropriately is important. Also where there are multiple locations, such as retail, anything that has a branch network where you are limited by the time period on rejecting real property leases to the 18-month exclusivity limitation. You are looking at trying to file more strategically than ever before because you do have a hard stop from an exclusivity perspective.

Susan Freeman: In every case, you are going to try to evaluate before you file how you are going to get out. You try to talk to your client and sort out what the real problems are that instigated the need to file a Chapter 11 in the first place. Is there a way that you can do a workout instead of a filing? And if you do need to file, how are you going to get out? And I think there is even more emphasis now than ever before on really sorting that through quickly, making your decisions quickly with respect to downsizing your leased locations and that kind of thing.

But to the extent that you are really going to need creditor buy-in, you want to communicate with your creditors as
soon as possible. In most instances, that is going to be as soon as you file, except for the secured creditor and you are obviously going to need to talk to that secured creditor upfront and try and get some agreements with respect to your DIP financing.

Richardo Kilpatrick: Stuart, it has been proffered that the highest prospect for the reorganization of a small company is really based upon a pre-pack or some type of arrangement made with creditors prior to going in. Do you think that is still the case?

Stuart Gold: Well, I think it is important because first of all there is going to be a lot more heightened scrutiny. Obviously, US Trustee has more obligations for the small business debtor to oversee the operations of that small business debtor. And I think it is more important than ever for that small business debtor to have an exit strategy, even more so than even in the larger corporate cases because we have to get in and out relatively quicker than we used to in the past, and given the oversight that is going to be coming in, you better have a good plan to get out before you even enter into the arena.

Richardo Kilpatrick: One of the things that we saw on the creditor side were small businesses filed without cash
collateral being negotiated, without some type of understanding of what the debtor was going to do.

The new provisions under 1112 give us the ability to file the motions to convert or dismiss relatively quickly. And it also admonishes the court to do certain things, if we are able to prove of certain facts, such as, that the principals are dishonest or not trustworthy or they are not operating the business in the best interest of the creditors in the estate, and there is a non-exclusive list under 1112 that if the court finds cause, it is really required to either dismiss or convert the case or appoint a trustee or examiner.

So we have new weapons in our arsenal which we will probably be using in the small business case. The leverage in the big cases I think is going to remain the same. The biggest difference is going to be the capital requirements going in. Judge Perris, can you tell us a little bit about the statistics between small and large cases.

Judge Perris: Since we have finished up a little bit with what happens pre-bankruptcy, now we are going to focus on some of the changes themselves, in particular the Key Employee Retention Provisions that have gotten quite a bit of press and we are going to compare the recent court rulings in the Calpine and the Dana cases. We are going to talk about the exclusivity issues and some of the options there, the new requirements that
the committee share information and the protocols that have been developed in that area. Then we will shift to talking about the small business and individual Chapter 11 amendments.

To get some sense of where we are in the mix of cases in Chapter 11, we obtained the most recent statistics we could from the administrative office and how those break down. As pointed out in the earlier panel this morning, Chapter 11 filings are down about 25 percent over 2005, and I got the statistics for the period from October 17th through July 31st. And the breakdown was 9 percent consumer cases, 19 percent small business cases, and 72 percent larger business cases.

You should know that there are actually more individuals in that because the way these statistics are driven is by the nature of the debt, so an individual whose debts are primarily business debt will go into either the small business or the other business category. Well, what about KERPS? Those have certainly been one of the hot issues.

Lisa Donahue: Right. KERPS - this was something that all of us as practitioners were concerned about in terms of testing the waters with some of the big cases. I think that Calpine is really the first big reorganization that is going through since the change in the law. Refco was the first one to actually file but that was more sell-off of assets, a liquidation, rather than a reorganization.
KERPS, prior to the change, they were routinely approved based really on the business judgment of the debtors and there was a prevailing theory, which, I think, happened to be true, that it is harder to retain employees when you are a debtor in possession versus when you are even a distressed company, because once you file bankruptcy, people tend to just head out the door. And it was also based on the premise that the debtor was making sound business judgments and was really trying to work in the best interest of the estate.

Some of the critics of the KERPS – Congress, I guess – had said they felt that it was very top-heavy, it rewarded some of the very people that may have gotten the business into the problems, it was too generous, and basically paid people to stay, without real performance or milestones.

Richardo Kilpatrick: Well, Lisa before you go on, was there not a perception that the same people who created the problem were sitting in the driver’s seat and then giving themselves large rewards for entering into the Chapter 11 proceeding in the event that it succeeded or failed?

Lisa Donahue: Look, you can go across lots of different instances and I am certain you can find an example of an abuse; that is true. But I do think that in the last several years before the change in the bankruptcy code, because of activist committees and participants in the process, the KERPS were much
more milestone-driven, value-driven, and much less about a big bonus for just getting to the process and staying there, but there were abuses.

Richardo Kilpatrick: And the other thing I was trying to point out or bring out was the fact that you did have change sometimes, and, often, changes in management, going in just part of the chapter proceedings so that the perception of abuse was being abated as the statute changed.

Lisa Donahue: Right, and I think that is true. Out comes this new legislation that no one really knows what to do with. It seems very difficult for a practitioner, or a turnaround manager working with bankruptcy attorneys, working with the debtor trying to find a way to retain and motivate employees that are critical to the turnaround in order to provide an incentive plan to stay. Now, you have to have a bona fide job offer.

Now, if you have a bona fide job offer from company A that is not in bankruptcy versus your own company that you are with, once you get to that point, it is pretty difficult to retain the employee if they have a true bona fide job offer. Proving essential to the survival of the business is open to interpretation, and the creditors have lots of interpretations of “essential” for employee A versus employee B. And also
looking at limits and making the payout from the executive team proportionate to some of the workers in the tiers below.

Susan Freeman: But is this not just incentivizing employees to go out and find these other bona fide job offers -- what you do not want your employees to do...

Lisa Donahue: Right, it is - I am not sure what they were hoping to motivate but the concern that we all as practitioners had is that you find a bona fide job offer, all of a sudden it looks pretty good compared to what you have got.

Susan Freeman: With longer-term employment?

Judge Perris: Are you seeing the pay to stay and the severance provisions even really being used?

Lisa Donahue: Well, yes. In Calpine we did. What I think, just to kind of cut through it, what I think was good about the change is it absolutely gave perimeters and guidelines to how you can get some sort of employee retention and motivational-type program approved. And where we see - and we thought about this this morning - where we see flexibility is in (c)(3) because you have a little bit more of an opportunity, provided that you are covering more employees and going deeper into the organization and limiting the payouts, so nobody is getting rich off of a bankruptcy from a management perspective, but you are sharing the dollars to motivate the whole team to work to try to turn the company around.
I think that is right. So Calpine and Dana, and in the interest of full disclosure, my firm represents both Calpine and Dana from a debtor perspective. So we are going to be talking only about the things that were publicly filed and publicly commented on.

Susan Freeman: And these are really the two big cases that have dealt with these issues, post BAPCPA.

Judge Perris: And that is where we are focusing in those, in particular.

Lisa Donahue: Right, with very different results as most of you probably know. If you look at the two plans that were proposed, there were lots of similarities. Standard termination scenarios, i.e., what the companies had in place before they actually filed for bankruptcy. Bonuses were paid at time-specific emergence from bankruptcy, with the plan effective date as the common trigger. So it was not confirmation, it was actually effective date, and the values were based on total enterprise value, which, then, would assume the underlying performance of the business and value across the board to creditors.

So the big question is with those similarities between the Calpine plan and the Dana plan, why did Calpine get approved and Dana did not? Judge Lifland, who is the judge in both cases, came out pretty strongly and pretty affirmatively on a
couple of different things. He said that what Dana was representing was, a case of “walks like and talks like - is a KERP.” It cannot categorize a completion bonus of this size as any sort of incentive in that it was too large an award. And he said that the payments offered to the senior executives were more in the form of a non-compete and that is severely restricted by the new law, and then went further from a technical perspective on certain violations of different parts of the new law.

What Calpine did was a little bit different; it covered 700 employees. So it went very deep into the organization and also tiered the plan so that you had five different elements of it - the executive; the emergence; the management incentive plan, which again covered 600 employees; the supplemental bonus, which was non-insiders and then the discretionary bonus. And then the discretionary bonus people that were specifically named in other parts of the plan were not eligible for it, so it would be if someone was in accounting and they were not part of the plan but they did an extraordinary job, it was limited to - it was capped from an amount perspective but the CEO had the discretion to give that bonus to that person.

The Calpine plan also focused on operational and emergence targets. It was based on total enterprise value, and it started at a base of, I think, four billion, and if the
enterprise value went up, so all of the stakeholders in the process received more value than the employees and participants in the plan who are also entitled to more value.

The other key element and the difference between the Dana and the Calpine process is that Calpine’s plan had no objections and -

Richardo Kilpatrick: Is this not really the most important?

Judge Perris: Well, how did the Calpine generate no objections?

Lisa Donahue: It kept getting extended while there was kind of nibbling around the edges and negotiating with the various constituents to make sure everybody did come on board.

And the other key element on Calpine, and this just happened to be the Calpine dynamic, is market research had shown that a good number of the employees were paid well below market, and that was the key element to retaining people. I mean, if you have a bankruptcy and then, on top of it all, you are paying them below what the competitors are paying, you really cannot hold anybody. That was a big problem when we first filed, that people were going out the door. The bona fide job offers were very easy to get for the Calpine employees because they really were paid under market.
Susan Freeman: So the real lessons to be learned from this are to generate your creditors’ support by showing them how you’re structuring this in a way that does benefit the creditors, benefit the overall estate, and really have the evidentiary support for what you are doing.

Richardo Kilpatrick: Exactly, evidentiary support. Create a record. That is one of the things here. Stuart Gold: How much can this be done, pre-petition? I mean, how much can you do to get the support?

Susan Freeman: Well, you could certainly generate the market studies in advance to show you how the wage system, the salary system for this particular company matches up to the industry, and you can start generating your creditors’ support by talking with your informal body of creditors to the extent that you have an informal committee. Certainly, talk to your secured creditors, try to start generating that creditor support, and then as soon as you have the creditor group post-bankruptcy, you need to start communicating with them. Lay it out for them.

Richardo Kilpatrick: And it seems implicit again in the materials - there was a record created in this case, wasn’t there? There was an evidence put on in front of the judge in support each one of the assertions that was made in support of these motions.
Lisa Donahue: Yes.

Susan Freeman: Let us go from there toward pursuing the plan and trying to move the case forward quickly. We certainly have the overall plan of reorganization that you need to spend time upfront. You need to try and move the process forward as quickly as you can; you need to sort out what the business problems are and determine how to fix them. Sometimes that is a lot easier to do than other cases. I guess, Lisa, you have your standard timeline for a large case plan of reorganization?

Lisa Donahue: Right. The way we are looking at, say, Calpine ... Calpine is a big complicated case, and as I have mentioned, it is probably going to be the first big one that may test the limits on exclusivity or may test what happens when the debtor’s exclusivity runs out, and how do you deal with it? So Susan and I took the approach of let’s draw the timeline and let’s think about what some of the options are in a Calpine or a Dana or any other large company that has issues that may or may not fit within the required timeline.

But the way we approach this is we would say, “Okay, you file your plan of reorganization.” The process to actually solicit and confirm is five months, assuming things run fairly smoothly. And then we made note that Mirant took 12 months because of evaluation issues, et cetera, and with the objections, et cetera. So then we got to the point, we said,
“Okay, let’s say that you cannot get a consensual plan filed in time. What happens? What can you do?” You can file a confirmable plan and negotiate, or you have to think about who are the likely constituents that can file a confirmable plan.

And that the judge who, I believe, will try to maintain some sort of semblance of a process in this, that they will not allow just random plans to be filed in the interest of keeping control. Actually, Judge, you may want to comment on that.

Judge Perris: Well, of course, Congress pretty much told us that you get to a certain point and you are going to have that possibility. Now, whether creditors are really going to do that is a totally different question, I think. And that may be debtor’s counsel’s new mission, to make sure that the process is moving in a way that creditors out of desperation or in an attempt to gain leverage, or otherwise, are not filing plans, and I know you had some thoughts about that. I think courts are going to be likely in the large cases to give you the maximum that Congress says you can give the debtor now. But there is a finite limit.

Lisa Donahue: Right.

Susan Freeman: And so if you have a case like Delphi they filed just before BAPCPA, and need more time to negotiate with G.M., to negotiate with the unions to come up with something
that is going to work, you just cannot take that long to negotiate it now.

Judge Perris: Well, the real problem I have is what happens in the cases that need operational restructuring in addition to financial restructuring? They need to figure out what the impact of that operational restructuring will be financially before, realistically, you do your exit.

Susan Freeman: How can you prove feasibility under your plan if you do not have any kind of a track record, and all you are saying is, “Well, I hope it is going to come out this way, and I think it is going to come out this way over time and I have nothing to really back myself up”? And I did find that, “Oh there are these problems and I am going to tweak them and then it is going to be fine. And that is what I am telling you.” That might be all you can disclose in your Disclosure Statements.

Lisa Donahue: Even if you can get past the feasibility issue, which it is doubtful you can, it makes for very interesting valuation arguments from all the different constituents who are coming at it from several different agendas on value.

Judge Perris: How long do you realistically have during your 11 to do operational restructuring before you have to
negotiate and file your first plan? Six, nine months within 18-month total exclusivity?

Susan Freeman: But then what happens if you have a seasonal business?

Lisa Donahue: Right.

Judge Perris: They are planning for maximum dollars in over the holiday season, and now they are filing post-holiday season and sorting out how they are going to restructure, and next season is going to be better. Well, next season was not quite as good as you thought and now you are at the end of your 18-month period.

Stuart Gold: Well, do you think that the effect is going to be that we are going to be in a situation where we are going to be speculating more at confirmation because we had to get there early because of the exclusivity limits?

Richardo Kilpatrick: Well, the question is, are judges going to be more flexible with the feasibility issue as result of the time constraints? Susan Freeman: So what else can we do instead, Lisa?

Lisa Donahue: Well, one thing I can tell you is in a case filed in Harrisburg, Pennsylvania, the debtor lost exclusivity and what ended up happening is no one really knew how to deal with it. There were lots of fighting constituents
throughout the whole case and what Judge France did is put in place a protocol.

Admittedly this was before the change in the bankruptcy code, so whether or not this protocol would be available now is a different question, but he put in place a protocol covering all the parties and interests, that were likely to file plans and that includes the unsecured committee, the secured lender, the debtor. And then there was a subordinated note holder stuck in between, agreed on a protocol whereby there would be a 30-day time clock ticking, so to speak, that someone would give notice to all the other parties that we intend to file a plan. And there was a 30-day waiting period that would allow the debtor to file a plan to keep it on track. We had to deal with that type of environment for a year. And the result was no one filed the plan; the debtor ended up filing an ultimate consensual plan. If you were trying to relate it to BAPCPA it was not within the time period. It actually would have been outside of the initial exclusivity period.

But I guess the point is we all were envisioning this catastrophic event where there would be competing plans flying all over the place and ballots going out all over the place. It was handled very smoothly by Judge France in Harrisburg.

Susan Freeman: You had the exclusivity gone so there could have still been competing plans filed, but you
established a kind of notice and an opportunity for the debtor to come forward with something that is as close to consensual as it could generate.

Judge Perris: Well, of course, nothing changed in terms of the level of control the judge has in timing and case management when you do have competing plans. So certainly the judge is going to have some discretion in making sure that everybody’s plan gets a fair airing. And even if you cannot have a protocol exactly like what you had, certainly you can have… Just by how you schedule things you can give people time to talk to each other.

Lisa Donahue: Right. That was the theory; the docket is the judges.

Richardo Kilpatrick: Bullet point three is “request court approval of various case management structures.” Are there other examples other than the control that the court has over distribution of the various plans in voting? Are there other mechanisms, Lisa or Susan, that you can create to give the debtor a little bit more control, even if exclusivity goes by the wayside?

Susan Freeman: Other than trying to negotiate something and trying to reach an agreement with your creditors, I do not really have a bullet point that I could give. I think the most important thing is to have that transparency, to have that
effort toward reaching a consensual plan. If the debtor is just going to bulldog his way right through and say, this is my company and this is my process, and I am the one who is going to control this, without trying to negotiate something that is consensual, then the debtor is just asking for trouble. It’s just asking for the creditor constituents to get together and a secured creditor to try and get the committee to agree to, “All right, well, we will give you this kind of treatment and this amount of money and then we will go forward with a creditor plan.” That is really the option that you have.

I think the most important thing from the debtor’s perspective is to communicate as much as possible about, really, what the problems are, why it is important and useful to have a single plan instead of competing plans, and to be able to come up with something that works.

Lisa Donahue: I think that is right.

Judge Perris: Well, at a practical level the end of exclusivity gives the creditors a right to file their own plan and how valuable that right is is going to vary a lot depending on the case. Most commonly in the smaller to midsize cases they are just liquidating plans, and whether that makes sense for the creditors really depends on whether this entity is more valuable to the creditors or at least as valuable on a liquidating basis as it is on an operating basis. Often that
is the rub of the benefits of the end of exclusivity is, it is not; there is little or nothing for the unsecured creditors and it is only the secured creditor who is going to benefit. In the larger cases, it certainly gets far more complicated than that.

Richardo Kilpatrick: Judge, I think that the dynamic is going to change with the smaller cases now because of the constrained periods for both disclosure statements. The constraints on exclusivity and on confirmation in small business cases you might see creditors filing plans.

Stuart Gold: Or you might see creditors doing more liquidating plans, right?

Richardo Kilpatrick: But you know the plan is going to read, my client gets all the collateral; the debtor gets nothing. And we are going to carve out 20, 10 percent for the unsecured creditors. I mean, you will see those types of regressive plans, particularly, since - again, I think that our economy is worsening right now. Stuart and I are both from Rust Belt and the problems have not abated.

In Detroit, there is a major restructuring going on and all the industries that are associated with our economy, and the problems are there. They are being worked out, pre-bankruptcy, right now. A lot of companies are avoiding, the suppliers are avoiding the filing of Chapter 11 cases because
they do not know what is going to happen in the Chapter 11 form number one. Number two, both sides are trying to take rational positions and give them the opportunity to reorganize.

The things that we are seeing now are to take care of the problem. Make the company viable; allow it to emerge without going through bankruptcy and then bankruptcy being the very, very last alternative. But we are going to see a number of Chapter 11 cases filed in Detroit and in that region that has all the manufacturing in Indiana, Ohio, Illinois, and Michigan.

The strategies are being worked out right now and one of them will be competing plans filed by creditors. My client gets the collateral, unsecured creditors get a small percentage of what’s left the debtors walks away.

Susan Freeman: Well, and it may just be that the business plan does not work anymore. I am sorry--the industry has changed. You have got your head in the sand if you think you are going to be able to turn this around and make a profit. You just cannot make it and pay off my secured debt and, I’m not willing to let you keep trying with my money. “Hey, I loaned you the money; you owe it.” Sorry, it would be nice to have a company for the suppliers to keep supplying, but the business model just does not work.

Richardo Kilpatrick: If you come in with a business plan that shows some viability and some meaningful way of
restructuring the business, that is the first thing we look for right now.

Susan Freeman: So let’s move from there toward some committee issues, in particular, the new change in the Code with respect to committees since the addition of 1102(b)(3). The committee must provide access to information to creditors who are not on the committee but who hold the same kind of claims as those on that committee – unsecured or equity, whatever – and then solicit and receive comments from them, and be subject to any court order that is requiring them to do something more. And, of course, this is taking into account that constituents’ views do need to be heard and they do need to be promoted and they do need to be protected. The committee members and committee counsel have fiduciary duties to make sure that exactly that happens, and there certainly has been a perception of problems in that regard.

And I think that is what the legislation reflects, that that had not happened in a number of cases, and people were feeling like they were not heard and their views were not taken into account. They were complaining, and the ones who were complaining were people who had some access to Congress and, in fact, the law did get changed.

The other thing that is important for the committee counsel to be taking into account is that they really have an
obligation to make sure that all of the committee members’ views are taken into account to the extent that those members are reflecting a particular constituency as they often are. You know, “Here is my trade group. Here is my tort group. Here is my bondholder group.” You need to take all of those views into account.

And I think most of us in the bankruptcy community are certainly aware of the Fibermark case and the examiner’s report. They are about how one committee member was really just bullying the rest and not taking into account all of the committee members’ views, and just how important it is that that take place. And then the new law requires that that take place in more depth by reaching out and reaching down further into the constituents. But in doing so, in trying to meet the requirements of Congress, you the committee counsel and the committee members have to take into account the need to protect this confidential information that you are getting from the debtor, because you really cannot do your job if you are not getting confidential information.

And, from the debtor’s perspective, if the debtor gives confidential information about business plans, how it is going to restructure, anything about trade secrets -- if any of that leaks out to competitors, then that is going to harm the debtor. That is going to harm the debtor’s business; it is not in the
interest of the plan of reorganization, overall, and it is certainly not something that is going to help the creditor body as a whole. So the creditor body should be concerned about that, and the committee and the committee counsel have obligations to ensure that that just does not happen.

That is especially problematic when you are dealing with a publicly-traded company, because you just cannot leak insider information out to enable stock trading. The SEC regulations prohibit that. You cannot give information even to the committee members unless they have confidentiality agreements, and so to the extent that you are going to be providing that information further into the community, then you just have to have those kinds of trading restrictions. You have to prevent facilitating insider trading, you, the committee counsel.

And then, of course, you also have to be aware of the committee counsel attorney-client privilege, which can be waived by just sharing the information with people who are not committee members. There have been cases that really kind of narrow the committee counsel privilege when you are dealing with constituents, but those are ones where the constituents are in the midst of litigation with the committee. They are trying to get information, and then it is kind of treated like a shareholder derivative case or a trustee beneficiary case where they are entitled to more information. And that is fine,
but when you are taking about just overall conduct of the committee, you need to be able to share the attorney-client privileged information.

So what do you do in terms of complying with the statute, which says nothing about any of this, and yet complying with your fiduciary duties and your duties to maximize the distribution to creditors by not harming the debtor in its operations? We have one opinion; that is the Refco opinion, and it is from Judge Drain, and it really approves a protocol, and the protocol is very helpful.

It does authorize the committee expressly to withhold this proprietary information, the confidential information. It expressly authorizes withholding privileged information and withholding information that would be - where any disclosure could be contrary to law -- such as trading information. It authorizes you to take into account whether there are confidentiality agreements in what you send out, so that even with this protocol, it is saying if you want to give information to a particular constituent that is coming in and asking for something, then you can say, "Give me a confidentiality agreement. Give me a trading agreement. I need to see that you are not going to be abusing this information, and maybe even sharing it with your client. Or
you can only give this to counsel for that particular creditor.”

It provides for a committee website as the means for giving information on a regular basis to the committee constituents and getting the information from them with e-mail addresses and supports that method.

And, importantly, for committee counsel and committee members, the Refco order exculpates them from any liability to the extent that they share information and that information does end up being abused. The standard that is set is really the same standard that you have as a matter of law, anyway. So it is not really adding that much but it does kind of have it there in black and white, and I think that does discourage litigation.

Judge Perris: Susan is just trying to convince the judges in the audience that, really, providing the sort of advisory opinion is fine because it is just a restatement of the law, and you are not really doing anything. That was one of the issues I think that was raised in Refco, and I am curious what your experiences around the country and your cases - whether judges were, as a matter of routine, going to sign off on protocols and enter orders approving them, or whether, as Judge Drain said in this opinion, “This is the first one to come up and it was a contentious case with very serious issues.
Appropriate to do it this time, but it does not mean I am going to do it forevermore.”

Susan Freeman: Right. And I think you may not need it forevermore if you have these kinds of opinions out there. I certainly have had cases where I have not gone in and obtained such an order, and instead waited to see if there were going to be problems with the constituents of the committee, problems with anyone coming forward and asking for information, refusing to sign the confidentiality agreements that I would require before giving them that kind of information, and just sending out reports as things happen in the case that are important to let creditors know how the case is going.

But to the extent that you have a larger case, certainly this kind of thing is very useful. It is a comfort order, but it is a comfort order that is important in letting a vast number of people know what is going on and what the rules are, what they can expect, how they can communicate. I think the websites are useful but the websites are not something that you would certainly require in every case. I put in some citations in the materials to protocol orders in other cases that are considerably less detailed than the Refco case, in some where they are not providing for websites and, instead, just saying, “No, you do not have to give out privileged and confidential information.” And some orders are included that authorized
less detailed but still close to a Refco opinion in terms of the requirements or the procedures for counsel.

Male Voice: Do you think it is running up the cost of representing committees to have this provision?

Susan Freeman: Yes, frankly, because it is requiring more time and effort. It is time and effort that Congress has said needs to be expended in terms of communications. But, yes, setting up the websites takes time and money.

In one of my cases, USA Commercial Mortgage out in Las Vegas, we have four committees so we have four committees and the debtors, multiple websites; instead of just having a single website, each committee has to have its own website to communicate with its individual creditors that have its own individual reports. This is what the Diversified Fund is telling its constituents versus what the unsecured creditors committee is telling its constituents. They are all interrelated so you can flip from one to another, but in order to get access to a particular kind of information you have to be that particular kind of creditor, and, thereby, get the passwords to get in. And, yes, it is certainly more complicated.

Let’s go from there into small business bankruptcy issues.

Richardo Kilpatrick: Thank you. This particular area and topic really is not the sexiest part that we have been talking
about. There is no Dana to talk about, no Calpine to talk about, or Refco. It is still relatively new in the sense it has been a year, but there has not been that much in the area of case law. I do want to start off with a statistic that we did not bring up before to give you an idea of the impact of this particular provision.

According to the Census Bureau, statistics from 2002, there are roughly about 17.6 million entities that are people just in business by themselves; they have no employees whatsoever. And then about 5.6 million are employer firms that have employees. And if we break that down a little bit, we see that if we look at the receipts and the revenues of these particular firms, almost 94 percent of those firms have less than $5 million in revenue in the course of the year.

So this has a potential for substantial impact in our economy, and Congress has taken a close look at this in trying to determine what is the best way to effectuate assisting these entities in the bankruptcy arena. And so they defined that, initially, as a business enterprise with less than $2 million in non-contingent liquidated debts –

Susan Freeman: That is a pretty small amount. I mean, if you have got a $5 million income you are going to have more than that in secured debt to finance your operations.
Richardo Kilpatrick: If you do not, you are not in bankruptcy. I agree; it is a small subset of the business bankruptcies, but it is indexed, so maybe it is going up as inflation goes up, but it is not going to have that major impact on most businesses. They are subject to some manipulation in determining whether or not you are a small business. You do make the initial check-a-box on the petition itself that was mandatory in the past; it was an elective provision. Now it is mandatory if you meet those criteria. But I suppose you can get together some of your close suppliers and form a committee, and that takes that out of the small business arena if that is what you really want to do.

One of the issues I suspect that might come up during the next year or two as we get more interest in this particular area is what will happen if you started off as a small business bankruptcy, and then 120 days or so you do not meet the criteria because one of the definitional points is that if your creditor committee becomes ineffective, so...

Susan Freeman: So are you effective or not?

Richardo Kilpatrick: Yes, I mean, obviously US Trustee is going to be looking at this particular area. So if you are in 120 days under this program and you think you have to file a plan which is required within 180 days basically, but then your
committee becomes ineffective, does that take you out of the small business definition?

Susan Freeman: Well, likewise if you file, and you concluded that it makes more sense to be out of the small business category, do you then really try to negotiate among your creditors and encourage them to band together and form a creditor’s committee?

Richardo Kilpatrick: Exactly.

Susan Freeman: It will not take that much work on your part but you really need to do this, and this is why it is going to help you.

Judge Perris: Well, actually I think that would happen pre-filing for some debtors if you are working on it because probably debtors would prefer not to be subject to these small business provisions because it imposes a whole new layer of requirements and shortens up your plan period. And so all they really have to do is recruit some of their friendly creditors to serve on the committee. As long as they have an active committee they will not be a small business case.

Richardo Kilpatrick: Yes, so it does - we will have to wait and see how that plays out, quite honestly. There have not been any reported decisions at the moment.

Susan Freeman: So what are the problems with being a small business?
Richardo Kilpatrick: Well, we have substantial reporting requirements, periodic financial reports, profitability, projected cash receipts and disbursement, actual versus projected comparisons and routine post petition compliance. These are more so than even in the big cases, quite honestly. Congress again has felt that it is necessary to have this increased oversight over these small business cases, because when you ask the small business to bring in their financial records, they basically bring in their tax returns. They do not have these types of documents.

Male Voice: I was going to ask Stuart if the normal small business owner who shows up at your office has any of those available at the time that they come in.

Stuart Gold: Very, very rare.

Male Voice: Do they have it available two months thereafter?

Stuart Gold: Quite honestly, it is unfortunate. If they have these types of reports and financial information perhaps they would not be in the situation that they find themselves in. I think if they went to a small business administration conference and learned a little bit more about what it takes to have a successful business, I think a lot of these people would not be failing and seeking bankruptcy relief.
Male Voice: Well, putting my creditors head-on, Stuart, seriously are the principals of the small businesses going to be able to prepare these things or are we looking at another overlay of expense?

Stuart Gold: Clearly, another overlay of expense. Now the principals, generally, they want to work in the shop. They do not want to be doing the bookkeeping.

Susan Freeman: That is something that needs to be done; you need a bookkeeper, you need a financial adviser, someone to help you run this business, not just as a matter of selling and buying but as a matter of running the business.

Judge Perris: But let’s step back for a minute. Most of these provisions came straight out of the Bankruptcy Review Commission Proposal and there were two themes to that. One was to sort out those who were really dead and get them out of the system quicker and at less cost. The second was for those who are alive, to get them through faster and at less cost.

Stuart Gold: Less cost, exactly. And that is basically what these amendments propose. I mean, trying getting in and out in 180 days, basically, six months. The combination of the plan and the disclosure statement, there is going to be a use of standard forms. The judicial conference is going to prescribe forms. It is almost going to be like a model Chapter 13 plan as what I think people are envisioning, that you just
fill in the blanks basically for the most part, and you have your plan approved by the courts.

As long as it contains sufficient information, the court will approve those at the confirmation hearing, basically. So there is a streamline process that is in place, again, that is going to reduce cost, hopefully, in the long run, reduce attorney fees and other administrative costs.

Judge Perris: Well, my sense is that this will work if you have a plan going in. If you basically know what you as debtor’s counsel and debtor are going to do going in, it will expedite the process, it will drive down the cost. If you are coming in to flounder around, it is probably more expensive, given all of these reporting requirements. And so for the small business debtor, it seems like the opportunity for operational restructuring within a Chapter 11 is even less than it is in the bigger case.

Richardo Kilpatrick: My experience has been that many cases are filed because the line of credit is being pulled, or there are some other precipitous actions. I think the judge is absolutely right; there has to be some concept of what you are going to do, how you are going to reorganize this business, what changes have to be made prior to even going into the process in getting in to the Chapter 11 case.
Susan Freeman: And do all those requirements about what you need to bring and file with you help in making that happen?

Stuart Gold: Sure, absolutely. First of all, you educate your own client as to what is going on and what it is going to take to really get out of it. That is what we said at the very beginning of our session here; you need this exit strategy before you file a petition. If you have the time, take full advantage of it.

I think this is what Congress wants; if you are going to file and you want to flounder, get out. Do not stay in here. You have wasted your attorney fees, you wasted the filing fee, you wasted everyone’s time. But if you have a plan going in, then you are much better off and hopefully successful in getting your plan confirmed.

Richardo Kilpatrick: From the creditor perspective exit strategy, your best loss is today’s loss. If an entity goes into bankruptcy without any of these things, not knowing where they are going to go, it is probably going to behoove you to try to get something done relatively quickly, file your motion for conversion or dismissal relatively quickly to bring it to finality. Do not let it languish because the other implicit part of this is that there is new administrative expense that is going to be there. That bookkeeper, that accountant who is going to be preparing these monthly statements is going to be
paid just like the debtors’ attorneys, just like the quarterly trustees’ fees, just like all these other expenses that we have been accustomed to seeing in mega-Chapter 11s, which are now going to come into existence in the small cases.

Judge Perris: Well, one of the things that... It was a definite change into the small business amendments was a sense of a greater role for the United States Trustee. Initial meetings with the debtors when appropriate, more oversight, mandatory bringing of motions to convert or dismiss under certain circumstances. Has it been your sense that that is going on?

Stuart Gold: The answer is no. We really have not seen... at least in our district, we really have not seen that active involvement yet. Whether they are gearing up for it, I just do not know. I know they are gearing up for debtor audits; that is coming up the next couple of weeks, or maybe tomorrow, I do not know. But I know they are gearing up there, they are gearing up on the consumer side to 707(b) issues but we really have not seen this active engagement in the small business cases as of yet.

Judge Perris: We have always had it in our district for a long time, so we were not expecting much of a change and nothing really much has changed, but that clearly was the contemplation of the statute.
Stuart Gold: Let me just back-up for one moment here, just on the debtor’s duties to file their schedules in a timely manner. But if you want extra time, the old standard has actually been made more stringent and requires an extraordinary and compelling circumstance to file those schedules. So, again, not a reason to flounder; you should have that done, quite honestly, right before you file.

One of the keys, and we keep harping on it, is that before you file you got to have an understanding of the viability of your entity. I mean, this does not make sense to, again, file a Chapter 11 unless you are going to be liquidating obviously, and you have a purpose in doing that, but if you are going to continue to reorganize, you want to assess that viability right upfront. And that is one the duties that the US Trustee is going to be undertaking supposedly under these obligations.

Susan Freeman: And then what happens if you do not confirm your plan on time? Is there some pretty stringent time limit here?

Stuart Gold: Well, there are. I mean, there is the initial 180 days which may be extended an additional 120 days.

Richardo Kilpatrick: So, a maximum of 300?

Stuart Gold: Well, you can actually get even a little bit more, perhaps, and then you are judged, Richardo. But that is going to be very closely monitored purportedly by the U.S
Trustee and the courts as well. Again you are either going to live or die within basically 300 days.

Richardo Kilpatrick: To obtain that additional period of time, there is a showing that has to take place, is there not?

Stuart Gold: Well, sure, you must show that you are going to actually be able to confirm the plan within a reasonable time period. You obviously have to get your order entered before the expiration of any particular deadline. Interestingly, the other deadline which is somewhat confusingly written requires confirmation of the plan within 45 days of it being filed. If you sort of read that statute it almost suggests it is mandatory that the court confirm a plan within that time period, but obviously, I do not think that was the intent.

Susan Freeman: Judge Perris, have you seen any problems with that, people not being able to confirm within 45 days?

Judge Perris: Well, it clearly does not work if you are going to do the traditional disclosure statement on 25 days’ notice, confirmation and validating on 25 days’ notice. You are already over your 45 days. The only way it works is if you combine the plan and disclosure statement, or the plan is the disclosure statement as is one of the options, or somebody has to come in and ask you to extend the time. It seems to me those are really the options at that point.
Stuart Gold: On that serial filing, this is sort of a holdover, I guess, from consumers’ side of 362 and provides that there is no stay if there are two cases pending at the same time. I suppose that is a rarity but it could happen, if the prior case was dismissed or confirmed within the previous two years, or if a debtor’s assets required substantially by the new entity who is seeking relief within two years of the prior filing. There are certain exceptions.

I think the question that this sort of raises, at least for me, is whether or not these provisions perhaps might chill the bidding of a debtor’s assets. We are going into liquidating; someone purchased those assets and then realizes that if they do not make a goal of it, will they have problems with the state two years or within two years of their acquisition?

Susan Freeman: I think the statute was geared toward the abusive filings. Well, my stay was lifted and I cannot get my additional filing so I am going to transfer it to a new entity that is owned by substantially the same people, or by my brother-in-law, and then that entity can go forward. But I doubt that you are really going to have the court preventing a stay from taking place if, in fact, you have acquired the asset through a legitimate sale.
Stuart Gold: In good faith, absolutely, it overrides everything in connection with that provision.

Judge Perris: Well, the other thing is the exceptions in this statute, or such, that I would not want to advise a creditor if I were a lawyer to rely on no stay existing without some sort of judicial declaration. It reminds me a little bit of 362 (c)(3), I think it is, with respect to the two-time filer by the debtor. I am not sure that creditors got very much in this particular provision.

Susan Freeman: But if you are selling under a plan or selling any kind of an asset, can you put in something that is the equivalent of your good faith 363(m) language that is going to say, “I am fine, I am not acting in bad faith-“

Richardo Kilpatrick: I am an independent third party who is buying at arm’s length so even though I maybe related to the principal of the existing debtor but -

Stuart Gold: Get your blessing ahead of time.

Richardo Kilpatrick: Yes, well, we just did a study of the 362(c) cases and what the judge said is really important. I do not counsel any client to move forward without some type of ratification from the court that the stay has indeed been vacated or there is some type of a relief from, say, even if there are these automatic provisions. There is a very good
decision by Judge Waldron which people should take a look at as far as the effective 362(c) that was recently published.

Judge Perris: Alright, individual cases. Should we talk about those for a minute?

Susan Freeman: Anything more that you wanted to say about a study of small business debtors? Is that the study that you were just referencing, or is there something else?

Stuart Gold: Well, this is mandated under the statute that there is going to be a study conducted through the SBA and the through the U.S. Trustee, and I understand that the ABI is actually going to be actively involved in assisting in this particular activity, as well. And they are supposed to report hopefully one year from now, we will know a little bit more about the small business amendments and their impact on debtors and creditors.

Susan Freeman: How about individual Chapter 11’s that are now quasi-Chapter 13’s?

Judge Perris: Well, certainly, the amendments make the individual Chapter 11 case more like a Chapter 13 case in certain regards, and I will talk about what they are in a minute. But I thought it was worthwhile to remember why we got here. Really, I think there were two motivations or two issues. The first was certain governmental agencies, particularly the SEC, as I understand it, were interested in assuring that if
high income individuals filed Chapter 11, how much they had to pay to get their discharge in Chapter 11 will be driven not only by what their assets were but also by what their earnings were for a period of time.

Second was, with all the changes in Chapter 7 and the means test, you want to make sure you kept the playing field level for debtors so that you did not want debtors strategically using Chapter 11 as a way to circumvent means testing driving them into Chapter 13. You did not want people to be able to come through Chapter 11 devoting less of their earnings than they would have had to if they had gone through Chapter 13.

So what are the impacts of the changes? To try and get at that I, of course, could sit here and speculate and talk to the few people I talk to, but I thought I would do something a little more systematic. I got some statistics from the administrative office and I decided to take a little closer look at some of the early cases. I was sort of shooting for a hundred as a nice round number, but what that worked out to be was cases filed October 17th through January 31st because I wanted see what happened to them. Did they make it through the system?

And what I found was - and keeping in mind that when I looked this in mid-September these cases now are 8 to 11 months
old, 57 percent of them had been dismissed or converted so far; 3 percent, only 3 percent, had had their plans confirmed, and 40 percent were still pending. So I would expect the rate of plan confirmation to go up in a significant way from 3 percent, but, still, we know it will be a minority that will confirm plans. I cannot really say whether that is a change from under pre-BAPCPA because we do not have the data.

And, of course, one of the problems, pre-BAPCPA, were data problems; we are going to have a lot more data soon because we are going to start collecting a lot more statistics. I also sent a short questionnaire to debtors’ counsel and active creditors’ counsel who are mostly, from what I saw, looking at dockets – US Trustees. I really just want to get a feel for which of the changes, and there were many changes.

We are having the greatest impact in their handling of the cases, and here is what I found: Pre-confirmation, the change in what is property of the estate was having a significant impact. New section 1115 provides, in the case of an individual debtor, post-petitioned earnings are now property of the estate as is property acquired after the date of the petition, and that raises, really, a couple of different problems.

One is, of course, that in Chapter 11, to use property outside the ordinary course of business requires notice in the
hearing. So you say to yourself, “Well, what is the debtor doing to pay for the food and their gas?” It is not really a business transaction. And I expected to see a bunch of notices in the dockets I looked at but it just seems like it is just happening by-and-large right now. I did not see a lot of notices of what the debtor intended to use for living expenses, and there was case law, pre-BAPCPA, that is cited in the materials that talks about what is the standard, and whether approval or notice is required.

If you do have to have some sort of notice, what standard of living does the debtor get to live to? Is it the debtor’s usual customary standard of living which can be highly variable?

Susan Freeman: And which prompted Chapter 11 in the first place.

Judge Perris: Then when you get to the area of plan in the confirmation requirements, there is a new requirement in section 1129(a)15 that in the individual debtor’s case if an unsecured creditor objects, and the unsecured creditors are not being paid in full, the debtor has to demonstrate the value of the property to be distributed under the plan is greater than or equal to the debtor’s projected disposable income for five years after the first plan payment is due. It looks very much like Chapter 13, for those of you who are familiar with Chapter
13. But, actually, it is a little different because the cross-referencing referenced back to below-median income debtors in Chapter 13. For those debtors, they get reasonable living expenses as opposed to above-median income debtors who get IRS standard expenses.

And so the Rules Committee that drafted the form that goes with your Chapter 11 filing interpreted exactly that way – that it will use reasonable living expenses. You are not going to use the IRS imputed standards. In Chapter 13, we are having a roaring debate in the case law now about whether projected disposable income really means current monthly income which you recall as a historic number based on actual income for the six months prior to filing; or times whenever the commitment period is five years, or whether if circumstances have changed and debtor’s income is up or the debtor’s income is down, whether you use what is the real income as opposed to some historic number; and that fight has yet to play itself out in Chapter 11.

When I looked, there were no reported cases in Chapter 11 on these individual amendments. And there will be a question of how much it travels from Chapter 13 to Chapter 11, but I expect the Chapter 13 case law will be instructive. One of the questions is the extent to which the absolute priority rule continues to be viable with respect to individuals because modified section 1129 B2b now provides that when you are
cramming down on the unsecured creditor class, you do not... it says except in the case of an individual, you do not consider the 1115 property, the earnings and the after-acquired property.

And one of my survey respondents was so enthusiastic, he said, “This is great, the absolute priority rule has been eliminated for individuals and I filed four cases since the amendments went into effect.” I am not sure I interpret it exactly the same way but obviously that would... if that were true, if that is what it turns out to be, that would be a plus for individuals because it is really hard for them to satisfy the absolute priority rule, as demonstrated by poor farmer Ahlers a number of years ago in the Supreme Court’s decision.

Post-confirmation, the deferred discharge was the biggest problem identified by respondents. Under the amendments, the discharge for the individual debtor is deferred until planned payments are completed; and I was musing about when our plan payments completed? Does that mean after you paid all your secured debt? It could be many years. But the court has given discretion on request to enter an earlier discharge once the full amount has been paid that is due under the best interest test. Nobody identified plan modifications as a concern.

I think this will become a much bigger concern as the years go by because for individual debtors - and this is
special for individual debtors now. Their Chapter 11 plans will be modified until plan payments are completed.

Susan Freeman: So disgruntled ex-spouse or her new husband can come in and object, and say, “You have got to change that plan now.”

Richardo Kilpatrick: As the income grows.

Susan Freeman: As the income grows. Have you seen any problems with the requirement that the plan “shall be paid from post-petition earnings” as opposed to someone who says, “I have got this big property here. I want to just sell it and be able to pay you from the proceeds and go on with my life?”

Judge Perris: Well, the statute actually seems to raise that possibility. You sell the big piece of property as long as the value being distributed equals the projected disposable earnings for five years, but I do not have any doubt that will be litigated. We want five years worth of earnings plus we want the big piece of property. And in terms of what has the impact been on cost and speed, actually the majority say that it does not make any difference on the speed of the cases but it is definitely running up the cost.

Richardo Kilpatrick: Thank you, Judge. Well, we have run out of time. As you can tell, we are still on the very early stages in the business reorganization area. The cases are going to start developing. We have the Calpine and the Dana
case which deal with some of the preliminary issues, but I think you are going to hear and see some of the things that we pointed out today being played out in real life in the near future. Thank you.

[End of file]
Judge Dow: A centerpiece of BAPCPA, and one of the most widely discussed provisions is the means test designed to channel debtors with ability to pay in their Chapter 13. It authorizes the court to dismiss a case if the debtors’ net disposable income exceeds specified levels. The presumption in favor of relief which used to exist has been removed. Income is measured by an average of the debtors’ pre-petition income in the six-month period prior to filing. Expenses are measured by a combination of objective limits establishing IRS standard and the debtors’ actual expenses in certain categories, with the safe harbor for those below the applicable state median income preliminary data suggests that only a small percentage of debtors are subject to the means test.

Accordingly, there has been relatively or comparatively few cases interpreting the provisions. Issues in the cases that have been litigated include the ability of the courts to consider ability to pay when ruling on motions to dismiss for bad faith, or on totality of circumstances when a debtor passes or is not subject to the means test, and the availability of certain deductions for debt payments or allowances in
situations in which the debtor has no debt payments or intends to surrender a collateral. The importation of these concepts in Chapter 13 has raised interpretive difficulties as the courts struggle to decide whether projected disposal income is a historical construct based on a six-month pre-petition average, as reflected on forms B22C, or is a forward looking concept measured by the debtors’ schedules I and J.

But in another hour or so all those issues will have been resolved. And here to begin the discussion and to introduce the panel is Larry Friedman. Larry is a Managing Director for e-CAST Settlement Group in New York. He is a former director of the Executive Office of the United States Trustee. Prior to his appointment, he was engaged in the private practice of law and also served as the panel trustee in the eastern district of Michigan. Larry?

Lawrence Friedman: Thank you, Judge. We have quite a bit of material to cover, so I’ll try not to take up too much time introducing the panel or with any preliminary remarks. I’ll say that it is a pleasure to be back here in Washington where I worked just across the street for three-and-a-half years, from 2002 to 2005. I spoke at dozens of conferences around the country during my tenure with the US Trustee Program, and I’m very pleased to be back here with ABI in this terrific program. ABI has a reputation for bringing forth some of the best and
most educational and intellectual discussions with regard to bankruptcy. It is indeed a pleasure to chair this panel. I shall introduce to you today a superb group of panelists who has worked very, very hard in putting together a terrific set of materials which you have a copy of.

Let me get right to it. Andrea Celli, who sits to my immediate right, was appointed to Chapter 13 standing trustee for the Northern District of New York in 1995. Her office currently administers approximately 5,000 Chapter 13 cases dispersing about $25 million a year. She received her Bachelor of Science Degree from St. John Fisher College and her JD from Albany Law School. I know she has worked hard with NACTT and others to establish her reputation and credibility within the bankruptcy community, probably unwittingly knowing that - or not knowing that when she challenged the debtors’ right to find God in the throngs of financial distress she would become infamous, and not famous, for that decision.

To her right is Professor Michaela White, who is a professor of law at Creighton University School of Law in Omaha, Nebraska. She teaches bankruptcy contracts and sports law - how about them Tigers, huh? There you go, some Detroit folks here - she is probably best known for her work with Professor Culhane in a couple of ABI-funded empirical studies she has done with regard to bankruptcy and the usefulness of
the means test. I think that perhaps she will have some insight as to another study that she may be working on.

And to her immediate right we have Mark Redmiles, who is an old colleague of mine. He came to the US Trustee Program about 30 days prior to when I did in February of 2002. He is now Chief of the Civil Enforcement Unit there. He was instrumental in the development of the civil enforcement initiative and now with regard to the litigation activities on the means test, among other things, at the US Trustee Program. He was also instrumental in assisting us in transforming the US Trustee Program from a regulatory agency to a litigating component within the Department of Justice. Very pleased to have Mark here as well.

With that let me turn the program over to Mark, who I think will lead this discussion and take us through the areas that we would like to talk about, beginning with the means test and the IRS standards and how those allowances are given.

Mark Redmiles: Thank you, Larry. What we hope to do this afternoon is to cover four of the first issues that have come up in reported decisions under means testing or disposable income under Chapter 13 in your outline. The materials, the four different issues are identified. Each panelist is going to lead with one of these four issues, and then the other three panelists will weigh in.
The first issue is one that I’ll take, which has to do with the IRS ownership expense allowance. I preface my remarks with the cases on the ownership allowance because I think it applies to both the IRS ownership expense, and the second topic, which is surrendered property that Professor White is going to reference. I think there is a fundamental disagreement regarding whether the debtors actual circumstances matter in application of the means test.

And by that I mean one approach which is the approach that is endorsed by the US Trustee Program is that eligibility for an allowance, the IRS allowance or surrendered debt, that the eligibility is dependent on the debtor actually having that payment obligation going forward or it is dependent on the debtor actually having the expense. So that is one approach. And when we go through these I think you will see from the court decisions that some of the courts agree with that, that the debtors’ actual circumstances matter the facts pertaining to the debtor.

The other approach is that any debtor may take that expense regardless of their factual circumstances, so that their factual circumstances do not matter for means testing, and that these expenses apply regardless of what they are actual circumstances are. So turning to the IRS ownership expense, the issue here is you have ownership expense. You
have an operating expense both relating to transportation. In your materials you have the Hardacre decision and the McGuire decision.

Those were the first two that came out on this issue. They are both Chapter 13 cases, and there have been a number of courts that have since followed Hardacre and McGuire, and what Hardacre and McGuire say is that in order to take an expense allowance, if you will, for this ownership expense, the debtor has to actually have a loan or a lease payment obligation. And the reason they say this, how they get there is language in the statute that says the debtor takes the IRS, the applicable IRS standards.

And so the question is what does “applicable” mean? These courts would say in order to find out if this expense is applicable you have to look at what the IRS does, because, after all, the IRS is the entity or the agency that generated the standard in the first place. And if you look at the Internal Revenue manual, what the IRS says is that the expense is based upon the loan and lease financing, the average loan and lease financing charges across the country that it surveyed.

They figured out what the average cost is, and that the IRS, in applying their standards for the collection of taxes, requires the taxpayer to have a loan or lease payment
obligation. So when thinking of this expense it is called an ownership expense standard. I think it is actually more or like an acquisition expense. And so I think it helps to consider the standard, to consider this is the acquisition cost; and then you have the operating cost, which is the insurance and the fuel and maintenance and that type of thing.

The other two decisions that agreed with the conclusion in Hardacer and McGuire, but for a different reason, would be Domonica and Wiggs, both issued from the same judge in Chicago, Judge Barbosa. Judge Barbosa did not go to the Internal Revenue manual and say that that is not relevant for determining what “applicable” means, but this particular judge said the plain meaning of the statute, the plain meaning of “applicable,” suggesting you have to have a loan or a lease payment.

And then, Michaela, there are a couple of cases, or one anyway, that has gone the other way.

Michaela White: Yes, most recently a couple of cases: one from the bankruptcy court in the District of Delaware, the Fowler case; and one from the bankruptcy court in the Northern District of Illinois, Farrar-Johnson. The Farrar-Johnson case is on housing and it only analogous. However, the Fowler decision is specifically on the question of whether or not a debtor with a paid-off vehicle can take an ownership allowance.
The bankruptcy court judge in the Fowler decision very clearly addressed the exact issue Mark set forth: does the statute control?

In other words does the language of 707(b)(2)(A)(iii) indicate that the national standards and the local standards are the amount specified as the debtor’s expenses? Therefore irrespective of if the vehicle is paid off or if the debtor has no actual housing cost, the amounts – provided by the IRS chart of expenses – should be deducted. Both courts weighed in that, it is the amount specified by the IRS, not the manner in which the IRS might interpret its own standards, whether the national or the local, as specified in some portion of the internal revenue manual.

Andrea E. Celli: And before we leave this topic, let me just add one question that this will relate to in Chapter 13 cases. What I thought was most interesting about Hardacer and McGuire, and, in particular, in the McGuire decision, the debtor argued, “I need to put away money each month to acquire a new car. This is an older car. I’m going to have to replace it during the Chapter 13.” The court discussed that position and in dicta, said, that the test will be forward-looking and that this disposable income analysis in Chapter 13 and this ownership expense can be revisited.
From my perspective as the Chapter 13 trustee, my concern is where we are going with modified Chapter 13 plans. This court seemed to say we are going to be able to look ahead, and both the debtor, the trustee and the creditors will be in a position to modify the plan if there are changes in these expenses. And I think that is really the next frontier for the Chapter 13 practice.

Mark Redmiles: Okay, The last thing I’ll add on that, it kind of addresses what Andrea mentioned, and it comes from the McGuire decision, which is that the IRS does include in their manual for the older vehicle-type situations, a vehicle six or more years old or 75,000 miles or more, an additional operating expense allowance of $200 for each car that qualifies. And this is how the U.S. Trustee Program has applied it, consistent with the IRS in allowing this additional $200 for each, up to two cars with each of the vehicles if they qualify more than six years old and/or 75,000 miles or more. That is the additional operating expense allowance that is either to cover acquiring a vehicle, or it is true that you have an older vehicle, the cost of maintaining that vehicle will be increased.

Okay, the second topic we wanted to turn to was the whether or not a secured debt expense should be allowed for
property that is being surrendered. Michaela is going to start with that topic.

Michaela White: Thank you, Mark. Surrender, as you know, can happen either in a Chapter 7 case or a Chapter 13 case. In the means-testing arena, debtors are proposing on their Statements of Intention if it is a Chapter 7 case, or in their plans if it is a Chapter 13 case, whether to retain or surrender collateral.

Now, surrender, then, has a couple of different implications as it interfaces with means-testing, regardless of if we are talking about Chapter 7 means-testing, or the Chapter 13 means-testing for above-median income Chapter 13 debtors. As you know, of course, no Statement of Intention has to be filed in a Chapter 13 case. So the issue of surrender will be raised in a slightly different context. You will find the information about surrender in the plan.

Mr. White spoke this morning and urged all of us, to understand and fill out the forms properly. His point was especially important because part of the surrender issue concerns how to fill out the forms properly.

In the Chapter 7 and Chapter 13 context, if you have an above-median income debtor, case law has broken the question down to this: If the debtor is proposing to surrender the collateral and the debtor’s income is above-median, how should
we account for collateral and the collateral’s secured indebtedness on the forms?

So on Form B22A, now known as Form 22A, how do we deal with the amounts “scheduled as contractually due in the next 60 months divided by 60,” when the debtor, proposes to surrender that collateral? Are those amounts properly deducted, either as part of the ownership allowance deduction on the form, or on line 42? Remember, in either a 7 or 13 case, if the debtor’s income is above-median, the debtor is required to fill out the entire form. For purposes of a Chapter 7 case that can be very important because listing the secured payment might impact the equation and determine if the Presumption of Abuse is raised or not.

In a Chapter 13 case, it is also fairly important. There is a huge split in the cases in this area regarding the amount of money that has to be devoted to the plan during the applicable commitment period. If the debtor proposes to surrender the property rather than to pay it out, should those obligations be used in any way in calculating the amount of money that must be devoted to the plan during the applicable commitment period? Well, in the 7 area one of the earliest case on this topic is the Walker decision from the Bankruptcy Court of the Northern District of Georgia. That court says deduct it.
The Walker case involved an above-median income Chapter 7 debtor. The court said that inclusion of secured payments for soon to be surrendered property for purposes of the means test calculation was proper. If the debtor was proposing to surrender it, the court could consider the impact of the surrender under section 707(b)(3), the totality of the circumstances test.

An absolutely opposite answer to the same question in a Chapter 7 was taken by the court in a case called In Re Skaggs from Missouri. I have lost whether it is from the Eastern District or the Western District.

Lawrence Friedman: Eastern District.

Michaela White: Thank you, from the Eastern District of Missouri. That court said, “Do not deduct payments for surrendered or soon to be surrendered collateral in the means test calculation. Such payments do not properly belong on the form.” Inclusion of such payments might make the difference of whether or not a presumption of abuse is raised. The inclusion or exclusion of these payments determines if the issue is then visited in either a 707(b)(3) context or a 703(b)(2) context. It has come up a lot in the Chapter 13 arena.

To my knowledge, most cases, that have considered it, are in our outline. The McPherson case, the Edmunds case, and the Oliver case agree that, “the B22C is just a starting point.
The court will look at the projected disposable income, based on likely future income and expenses.” I guess that is all I have on surrender.

Lawrence Friedman: Professor, let me just interject for just a moment. I wonder in the Skaggs case, how much consideration was given to the fact that the debtors had already ceased making these payments pre-petition. Are we talking about actual expenses at the time of filing or those that are projected?

Michaela White: Well, I guess, maybe you can help me recall the exact facts of Skaggs. Had they ceased making the payments?

Lawrence Friedman: They had ceased making payments on the mobile home and the second vehicle, pre-petition.

Michaela White: Pre-petition. That may have the impacted the decision. Mark?

Mark Redmiles: I would just say that is typically the case that they have ceased in making the payments. I believe they actually returned the property. They did not even have the property. They had moved out of the residence. I do not think that is always the critical factor.

Andrea E. Celli: What you will hear as we discuss all of these topics is there are cases on point with the opposite holdings. And in this particular instance it is clear. One
court focuses on what is contractually due, allowing the expense regardless of whether or not it is going to be paid in the future, and the other court focuses on what is scheduled, allowing the expense only if the statement of intention provides evidence that it will to be paid. So we have two courts trying to interpret and just choosing one word over the other, and making their decisions based on that.

Mark Redmiles: And if I can add to that, it is maybe even more than that because it really came down to what the meaning of the word “schedule” is. Because on Walker, the judge in Walker read “scheduled” and said he was giving a dictionary meeting and I’ll have to say, after BAPCPA, I have seen more dictionary readings and I have gone to the dictionary more than any time previously to try and parse through what a word means in the statute. But he said a schedule means “regularly occurring.” It became due, and the US Trustee Program argued in Skaggs and the court in Skaggs found that “schedule” would mean “in the schedules,” that the debtor actually scheduled this as a debt that they were going to be paying for each month of the 60 months.

The court in Skaggs said, “This was not scheduled as contractually do for each month following 60 months.” And I think it is kind of like a vehicle ownership expense again. Do you look at whether or not the debtor intends to keep this
property and make payments on it, or do you ignore that under the means test and just allow this as a secure debt expense? And the result, you can correct the result under 707B3, totality of the circumstances, as where these situations can be cleaned up.

So as Professor White mentioned in the Walker [case] there is a 707(b)(3) claim under totality of the circumstances. It has been brief. There has not been a decision on that (b)(3) claim yet. In the NRA Fowler decision where the court said the debtor gets his ownership expense even though the debtor was not making a car payment, again, there was a B3 claim. In that case that was heard, and in the Fowler case the debtor decided to convert to Chapter 13 after the argument on (b)(3).

So I think, again, the fundamental difference - do you push all of these issues to 707(b)(3) in totality of the circumstances, or do you give, maybe, maximum utility to the means test and 707(b)(2) and look at what the debtor’s actual circumstances are.

Andrea, I think there is a little twist. I think the surrender cases are easier to analyze in Chapter 13, and so most of the courts in Chapter 13 have said you cannot take a secured debt because going forward for that five-year plan. And there is also the notion of there is a new contract with
the Chapter 13 plan. So it is not scheduled as contractually
due because you have a new contract with the Chapter 13 plan.

Andrea E. Celli: I also think that the courts are looking
to projected disposal income and a forward-looking approach.
And so consistent with that approach is the right to continue
to review schedules, to potentially modify the plan and capture
additional income and assets for the benefit of the creditors.

Mark Redmiles: And on the surrender issue, and I guess
the ownership expense issue as well, but I think it is
important to bear in mind that the US Trustee Program had an
interim step, if you will. We have the opportunity under
section 704 to not file a motion to dismiss if the US Trustee
believes it is not appropriate. And sometimes when the office
declines, it does not file a motion; it is situation where even
though the debtors surrendering the property or even though
they do not have a loan or lease payment, they provide a
document.

They provide, substantiate it. They either have a loan or
they have acquired property or they are replacing whatever it
is they are giving up. So they are back in the situation where
they, in fact, have a payment obligation going forward.

Lawrence Friedman: Unfortunately, this is not a topic
where we have too little material, but we need to move on. So
Mark will talk about retirement contributions and,
particularly, retirement loan repayments in Chapter 13, a very new and exciting area.

Mark Redmiles: Andrea is going to lead this one off. So go ahead Andrea.

Andrea E. Celli: As Larry said, I’m going to talk about the different treatment of retirement loan repayments in Chapter 7 versus Chapter 13 and the impact of those payments in a Chapter 7 abuse analysis.

There are basically three cases that have addressed this issue. This is an important issue and is still developing. I think it was pretty clear from the outset that these payments were not going to be allowable as expenses in the Chapter 7 analysis. They were not specifically allowed. Notwithstanding the specific language, arguments were made that they should be allowable under the other necessary expenses, which led courts to review the IRS manual’s discussion of involuntary repayments. Ultimately it was held that although payroll deduction payments were required, they were not a condition of employment and therefore the payments were not considered involuntary, and would not fall within those provisions.

There were also arguments that they were necessary for health and welfare which did not fare well. They were not required for the production of incomes, so they did not fit
within any of those criteria to have them allowed as an expense in Chapter 7.

In Chapter 13 on the B22C statement, they are allowed as an expense. Unfortunately the question has only come up in Chapter 7 cases.

The three cases in your materials are **Barraza** [2006 WL213 669(N.D.Tex.2006)] and **Johns** [342B.R.626(Baker.E.D.Okla.2006)]. I’m sorry, the third case you do not have because it just came out on September 26 is the **Thomson** case, and I have a Westlaw site for that if you want to add this to your materials. It is 2006 West Law, 2801882. It is out of the Northern District of Ohio.

Both the **Barraza** and **Johns** cases, say that these payments are not allowable expenses in Chapter 7. The **Thomson** case out of Ohio gives a very interesting analysis where the court finds that the retirement loan is a secured debt, and therefore is permissible as an allowed secured debt to be deducted as an expense on the means test. In the alternative, the court found that if it is not a secured debt, if taken up on appeal, the requirement to repay constitutes a special circumstance sufficient to rebut the presumption of abuse in the Chapter 7 context. I suggest you look at this case. It is interesting. Mark, I imagine it is going up on appeal.
Mark A. Redmiles: Yes, it has. A notice of appeal has been filed on that case, yes.

Andrea E. Celli: So, basically, there is this very stark difference between the treatment of these payments in Chapter 7 and Chapter 13. Most interesting is the issue which has come up when, in a Chapter 7 case the debtor is not allowed the deduction, but argues he should be allowed to take it because if he were in a Chapter 13 and you took the deduction, you would have no disposable income to be made available to creditors.

Both the Barraza and Johns cases, although without much discussion, say the payment do not create a special circumstance. The Thomson case says that it is, and I think we are going to have a lot more cases that discuss this.

Lawrence Friedman: Let me just pose one other additional question that has come up in this regard in Chapter 13, and that is if the debtor was previously, prior to filing, making contributions of, say, a maximum to a 401k and then borrowed money from the 401k and split his repayment from, say, $500 to $300 contribution and $200 repayment on his loan. The loan then is repaid within, say, two years of a five-year plan. Can the debtor now revert to upping his contribution, or should the $200 be paid to unsecured creditors?
Andrea E. Celli: Well, my position would be is that you have an opportunity to modify the plan at that point. This remains to be seen. I have not seen a case yet.

Lawrence Friedman: The creditor or the debtor would have the opportunity to monitor the plan.

Andrea E. Celli: That the creditor or the trustee would have grounds to modify the plan to bring that money into the plan. Again, we do not have cases yet on the post-confirmation modification of the plan and this is where this forward-looking approach is really going to come into play.

Lawrence Friedman: Excellent.

Andrea E. Celli: From the creditor’s perspective.

Lawrence Friedman: Well, it is an interesting point because if there was anything that was clear coming out of this legislation, Congress had a couple of policy priorities that they put forward. One was pensions and the other was raising of children by single parents. You have to consider those overall policy considerations in trying to bring some meaning to the statutory language.

Andrea E. Celli: One of the questions raised by the courts that have opined on this is why would Congress not allow it as an expense in the Chapter 7 and presumably make this money available to creditors, when in the Chapter 13, it is allowable as an expense and not available? So if they had
filed a Chapter 13, they would have that deduction. The courts have very frankly said they could not answer that question. From my perspective as the Chapter 13 trustee, I see some rational— you have a much longer term that the debtor is under the jurisdiction of the court and is subject to review of income and expenses, and so you have a totally different scenario in Chapter 13 than you have in Chapter 7.

From my perspective, the means test is really a safety net, not to deny Chapter 7 relief but just raise the presumption so that we can look more closely at those cases.

Michaela White: I think that the Thompson case that Andrea and Mark have just been discussing deserves a closer look. I would argue that the court makes a very compelling argument. Under the literal language of the statute and under applicable ERISA regulations, a 401k loan being repaid from the debtor’s wages is a secured debt.

The ERISA fund does not operate as the collateral. The ERISA fund is not property of the bankruptcy estate. That has been made very clear under BAPCPA. Nevertheless, since ERISA prohibits unsecured loans against retirement benefits arguably a 401K loan is a secured debt. The statute which authorizes certain deductions of secured debt from CMI would include this kind of loan. I think it will be an interesting argument to be heard on appeal.
Mark Redmiles: Professor White and I occasionally disagree on some of these issues. This happens to be one of those. To give you an advance of what our brief will probably look like, again, remember this is payment on a secured debt to a secured creditor. I think under the bankruptcy code it is clear that this is neither a secured debt nor a payment to a secured creditor.

The hanging paragraph of 362 provides that a loan from a plan may not be construed to constitute a claim or a debt under Title 11, and then, under Section 506, makes it clear in order to be secured that the estate has to have an interest in the property. So I do not think this is a secure debt or a payment to a secured creditor.

Again, you would have to read the entire provision. It is just not a secured debt. It has to be paid contractually due to a secure creditor. It was interesting in this decision. I do not see this very often anyway, but the court - I’m not sure the court was comfortable in the secured debt finding because the court said, “If a reviewing court disagrees with my analysis on secure debt, I also find that these are special circumstances” so we will address that, as well. I think the special circumstances, you have to look at whether or not there is a reasonable alternative for this debtor, whether there is an adjustment that is necessary, whether this rises to the
level of a special circumstance, and then what is the alternative? Remember, you cannot borrow more than 50 percent of what is in your plan, so you have the funds available to repay the loan.

Sometimes the question, the circumstances may matter. You look at the age of the debtor; you look at what is in the fund. But this was not an older debtor in this particular case. So, yes, we will see what happens on appeal.

Lawrence Friedman: And as if the specifically enunciated deductions did not leave a broad-enough playing field, we will go to other necessary expenses which broadens the field just a little bit and makes this application even more interesting.

Mark Redmiles: Let me move to the last issue we wanted to address, which was the discretion for the US Trustee first and then the court to consider the debtor’s ability to repay under the totality, the circumstances, 707(b)(3), that prong of 707. You have abuse. There are alternatives, which are you have the presumption of abuse. You can have your case dismissed under (b)(2).

What the statute says is if the presumption is either rebutted or it does not arise under (b)(2), then the court shall consider the case under (b)(3), consider bad faith, consider totality of the circumstances. What we are talking about here is if there is no presumption, the ability to pay is
not apparent when you apply the means test under 707(b)(2).
Can the US Trustee and the court analyze the same case under a
totality of the circumstances, revisit if you will, the ability
to pay using the debtor’s actual circumstances, as opposed to
some of the standards or some of the other information that was
used in the calculations under the means test?

I think it is important, this issue of whether or not the
court has discretion, I think, is very important. You saw it
from the earlier discussion. If the court may not revisit the
issue, how the court rules on the ownership expense, how the
court rules on surrendered property is paramount because that
is the only test if you cannot revisit it under the totality of
the circumstances.

Judge Wedoff’s Law Review article extracted in the ABI
journal and goes through that the court does have discretion
under 707(b)(3) to take a look at the debtor’s actual
circumstances. I think the egregious facts where this is
important is addressing the secure debt expense, which, many of
you know, has uncapped or unlimited under the means test.

So under the means test, if the debtor has two luxury
vehicles, two boats, owns a house and has a couple of vacation
residences, all of the debt, if it is all secured, all of that
debt is an allowed expense under the means test. Well, the
question is under 707(b)(3), under totality of the
circumstances, should the US Trustee have the ability to bring a motion to say, “That is abusive. This debtor should not be keeping all of that property and should not be paying for that debt at the expense of their creditors,” and then should the court have the discretion, the ability to dismiss that motion based upon those facts? So that is kind of one side of the argument.

Professor White has another well-read, well-researched Law Review article on the other side. I’ll let Professor White reference the other side of the argument.

Michaela White: Well, certainly the cases that have weighed in so far, the triple P's — In re Pac, a bankruptcy court decision from the Northern District of California bankruptcy court decision, In re Paret, a bankruptcy court decision from Delaware, and In re Pennington, also from the bankruptcy court in Delaware, certainly indicate that reports from my colleague and me concerning the death of judicial discretion are greatly exaggerated.

In all three cases, the courts were looking at below-median income debtors and examining their ability to pay, and if not the exact same way they used to examine ability to pay, pre-BAPCPA, darn close to the fashion in which they examined ability to pay. Consequently in those three cases, it appears that it is, at least for below-medium income debtors, business
as usual. BAPCPA has not changed the landscape much. In other words, the court will be looking at Schedule-I income minus Schedule-J expenses.

If we add the statement of intention into the mix we are brought back to the surrender issue. If the motor vehicle will be surrendered and no actual payments will be made in the future as in the Pennington case among others, then I minus J looks different than it might if the debtor were to retain the collateral.

I suspect that courts will be looking at the debtor’s lifestyle in the same way the courts did pre-BAPCPA. This introduces the issue of whether or not luxury goods, as Mark has characterized them, ought to be retained even if the Schedule of Intention suggests the debtor wishes to retain them. This seems to be the trend in reported cases.

Andrea E. Celli: We do have some above-median income cases as well. They are Chapter 13 cases where the trustee has raised a good-faith objection to confirmation of the plan and the courts have found, in at least in two instances, that the results of the B22C disposable income calculation are absolute. A very early case was the Barr case, and, more recently, is the Rotunda case. It will be interesting to see these issues develop on the below-median side as well.
Mark Redmiles: There have been a couple of unreported decisions where above-median debtors in the court came out consistently, saying it had discretion to review under a totality of the circumstances and (b)(3). I think the courts that say that the form is - the expenses for all purposes under Chapter 13, it would be similar to taking away discretion from the court under totality of the circumstances.

The Pak decision, which was the first decision that came out of the Northern District of California, cited in your materials is an interesting one, because I think it is not abusive but you see what the issue is. The debtor in that case was unemployed for either four or five of the six months during the current monthly income period, got a high-paying job in the neighborhood of $100,000 before he filed. When the hearing was held, this debtor actually had the ability to pay in reality because he had a $100,000 job at the time. But if you look at just the six-month pre-petition period, he did not, because he was unemployed, and in fact he was below the median in that case because he was unemployed.

Now, I mentioned to Andrea that what has happened in the Pak case now, at first I had heard rumblings that the debtor was going to appeal. I think they decided not to do that. They converted to Chapter 13 and what they did was to move to confirm a plan that basically relies on that six months pre-
petition income where he really did not have any, and so it was the Chapter 13 trustee objected and the US trustee in that case also weighed in, in support of the Chapter 13 trustee. So I think you see this issue in Chapter 13, as well, again relying on the form and kind of ignoring and projecting what reality is or what the factual situation really is.

Michaela White: I would say the cases are about even. However, the emerging majority seems to be that projected disposable income for above-median Chapter 13 debtors is a moving target. These cases indicate that projected disposable income ought to be calculated based on the situation at the time of the objection to confirmation, plan confirmation, or modification of the plan. As suggested earlier. But there are a number of cases, Alexander, Barr more recently. One case called Farrar-Johnson from Chicago suggests it is a formulaic approach. Projected disposable income for above-median debtors is captured on form B22C.

Andrea E. Celli: Well, I think that is another area where the modification of the plan is going to be the hotbed for litigation because we have all of these courts, the vast majority, in fact saying that that applicable commitment period is a temporal requirement. The question is going to come up when the debtor has proposed and confirmed a plan at the applicable commitment period, say, 60 months or and at 30
months, at 40 months, the debtor wants to complete the plan and pay out what was promised to pay over 60 months. That is where I think we are going to see litigation.

Lawrence Friedman: Right, and maybe you could comment, Andrea and the rest of the panel, on the litigation that has evolved with regard to the applicable commitment period when the result on the B22C form is zero, or a number less than zero?

Andrea E. Celli: I think we have seen those cases looking at projected disposable income. I think more and more courts are taking a forward-looking approach to income and expenses. I think that is why the courts are finding the commitment period to be temporal, so as to allow them to continue to review income and expenses on an ongoing basis during the course of the case.

Lawrence Friedman: It raises an interesting issue as to if, in fact, Congress intended creditors to have an opportunity for those above their means in a Chapter 13 to get what they could get over a 60-month period of time, if in fact it is used as a multiplier and the number is zero, and then you can confirm a plan. You may be out of the Chapter 13 before the 60 months comes.

Andrea E. Celli: One of the most interesting cases, if you want to look at one, is the Alexander case and it talks
about the applicable commitment period as being a temporal requirement, but, on the other hand, says if it is zero at the end of the means test, you can propose a plan that will pay your secured and priority debt and then pay zero for the rest of the temporal period. It is kind of a combination of both of those analyses.

Lawrence Friedman: Right, and one wonders how you reconcile that with all of the other provisions in the law that allow for a modification of the plan for ongoing production of tax returns and clearly an ongoing look at the debtor’s expenses and income for a five-year period of time.

Andrea E. Celli: I’ll put in a little plug for the ABI Journal because in this edition, which I think is part of everyone’s materials, there is an excellent article by a Chapter 13 trustee that provides a thorough analysis of the modification sections in Chapter 13. I do not think there are any cases yet published on it, but he did an excellent job reviewing the statute.

Lawrence Friedman: Yes, stay tuned. Perhaps it is a good time to take questions. Anyone?

Mark Redmiles: The question was what is the difference between what I’ll call the safe harbor, maybe, of 707(b)(6) and the safe harbor of 707(b)(7), which essentially says that for purposes of determining whether or not the debtor is subject to
dismissal under 707(b)(2), that the debtor includes their spouses’ income regardless of whether or not their spouse also filed bankruptcy with them. So 707(b)(7) says you would bring in the income and the debtor, the debtor’s spouse, regardless of whether they are also a debtor, and then you compare that with the applicable state median to determine whether they are subject to the means test under 707(b)(2) because if including the spouse’s income, they are below the median, their case cannot be dismissed under the means test under 707(b)(2).

However, their case could still be dismissed under a totality of the circumstances claim, under 707(b)(3), but only by the court on its initiative, or by the United States Trustee. A creditor could not bring a 707(b)(3) if they are below the median.

Lawrence Friedman: Yes. Perhaps you can stand, sir, and use the microphone.

Male Voice: Would not the interpretation that you cannot use (b)(3) if the debtor is below median income, would not that interpretation render (b)(3) totally meaningless in as much as the means test is only a presumption and not a determination of abuse?

Michaela White: Well, I think clearly Judge Wedoff’s article, which I guess is forthcoming in the Missouri...
Mark Redmiles: The full article is in the excerpts in the ABI Journal, correct?

Michaela White: My colleague Marianne Culhane and I will be responding to Judge Wedoff’s article in an upcoming ABI article. Judge Wedoff is correct on the technical operation of presumptions. We tried to argue as best we could. So far, we have found no buyers in the marketplace willing to purchase this idea conceptually that 707(b)(3) really ought to have a different kind of meaning than the Totality of the Circumstances test had prior to the enactment of the means test. In other words, arguably, the means test of 707(b)(2) gives an idea of what the debtor could reasonably pay over a three- or five-year period in a hypothetical Chapter 13 plan.

Given that pre-BAPCPA, nearly two-thirds of all Chapter 13 plans failed, arguably the numbers provided by the means test under the IRS allowances are better projections of what real people’s expenses are likely to be over three or five years. Given the solid empirical evidence that pre-BAPCPA plans failed at a very high rate, plans may or may not be likely to fail post-BAPCPA as well.

Our argument was it ought to take into account other kinds of conduct that deliberately game the means test itself. And so we tried to provide it with some content but as I have suggested so far, the courts are not weighing in on our side.
Male Voice: I read your article. It was an excellent article.

Michaela White: Thank you. You might be an audience of one.

Male Voice: My concern is that what you are saying seems like it would fall under the bad faith category, and not the totality of circumstances.

Michaela White: Well, we certainly tried in the article. Evidently we did not do a very good job of at least persuading the one person in the world who read it that bad faith has separate and different content. Indeed, we had some case law that could help us give content to bad faith, specifically that it was more akin to dishonesty, perjury, not cooperating in the 341 meeting, and the like. But obviously, we will just keep trying to persuade you in the next article.

Male Voice: You got me thinking. Thank you.

Lawrence Friedman: We suspected a question might be raised on this. Andrea, you want to take the question? It has to do with In re D’Agostino out of the Northern District of New York on whether or not charitable contributions are allowed for above-median income debtors in Chapter 13. That was the issue in that case. Andrea?

Andrea E. Celli: The question is where it is going; I understand that the issue will probably be dead very soon.
From what I understand, a bill has passed in the Senate - Mark, you probably know the status better than I do, that there may be a bill in the House -

Lawrence Friedman: A bill did pass the Senate. It was right at the end of the session. It has not gone to the House yet.

Andrea E. Celli: In all likelihood, the case will be overruled. Legislatively, it will be overruled.

Mark Redmiles: I’ll not speak to that. I’ll say that from the US Trustee perspective, we have filed briefs in, maybe, seven or eight courts on this issue. Our interpretation is that charitable contributions are allowed to both below- and above-median income debtors in Chapter 13, that the statute supports that, that in 1325 basically the charitable contribution allowance is off the table, if you will, before you look at 1325(a), and then also - it is also taken off under 707(b)(1), so it is complicated. But the view of the program, and we have weighed in on this, the first hearing, if it goes to hearing, is scheduled November 7th in Albuquerque.

Larry Friedman: Thank very much.

[End of file]
Judge Dow: After this presentation, we will have a short 15-minute break, and then we will launch into our last session which will be on the rules of procedure. The upcoming panel will discuss questions relating to responsibilities and liabilities of debtors’ counsel and the impact of the changes made by BAPCPA to debtors’ counsel.

Among the most significant changes that were effected by BAPCPA are new duties for, liabilities of, and restrictions on, debtors’ counsel. Debt relief agencies, a newly-defined term, are, under certain circumstances subject to sanctions for inaccuracies in the schedules and for cases filed, determined to constitute an abuse. New restrictions are placed on advertising materials and new client disclosures are required. Certain kinds of legal advice are now prohibited and may not be made by debtor’s counsel. Constitutional challenges, some of which have been successful, at least in part, have been made to some of these new provisions of the act. To what extent have these provisions affected the attorney-client relationship? How have the new liabilities and responsibilities affected the
time commitment required to put together cases to be filed under BAPCPA and the resulting costs?

These questions as well as others will be explored by this panel moderated by Lynn Tavenner. Lynn is a founding member of Tavenner and Beran in Richmond, Virginia. She provides representation to many different kinds of entities and business re-organization cases and creditors in other aspects of bankruptcy and creditors rights matters. I will ask her now to introduce the panels.

Lynn Tavenner: Thank you, Judge. We are honored to have an esteemed panel with us this afternoon. The first person that I would like to introduce is Norma Hammes to my immediate right. Norma is a partner with the law firm of Gold and Hammes in San Jose, California. She is the co-founder of the National Association of Consumer Bankruptcy Attorneys. She has served in many capacities with regard to that organization; she currently is on the NACBA Board, and she has worked many hours and prepared much of the debtor education materials that have been used to train the many thousands of members of that organization. She also has testified before Congress in the National Bankruptcy Review Commission. We are honored to have you with us today, Norma.

In addition, to Norma’s right, we have Henry Sommer. Henry is a supervising attorney at the pro bono Consumer
Bankruptcy Assistance Project in Philadelphia. He also previously was head of the Consumer Law Project at the Community Legal Services in Philadelphia. Many of you know Mr. Sommer as the editor-in-chief of *Collier on Bankruptcy* and all of the related *Collier* materials relating to bankruptcy.

Henry is a former member of the Federal Judicial Conference Advisory Committee on Bankruptcy Rules. He also is a fellow of the American College of Bankruptcy and member of the American Law Institute. He is also currently president of the National Association of Consumer Bankruptcy Attorneys. Also, we note that Henry was the first recipient of the National Consumer Law Center’s Vern Countryman Consumer Law Award. Welcome, Henry.

Finally, to Henry’s right, we also have with us today Mr. Donald Walton. He is currently the acting deputy director of the executive office for the US Trustees in Washington, D.C. He hails from Atlanta, Georgia. He was appointed as an acting US trustee for Region 21 in Atlanta in August 1992, and served in that capacity until June of 1997. If you look at his biography in the materials you will see that he has filled many positions with the office of the United States Trustee, and we are honored to have him here today.

With regard to the program that has been put forward on how BAPCPA impacted debtors’ attorneys, we have determined that
we will start off with Norma. Norma is going to give an overview of what is basically required of debtors’ attorneys after the new legislation. Donald will then address the US Trustees’ involvement in monitoring of debtors’ attorneys’ post BAPCPA, including lawyers filing pro bono cases and auditing of the debtor files. Henry will then follow up on Donald and Norma’s comments and address, among other things, the provisions with regard to debt relief agencies.

Norma Hammes: Thank you. My job as a debtor’s attorney certainly is impacted by the way the law affects my clients, the debtors. I have been practicing for 28 years and almost every working day involves me sitting down with someone with debt problems and helping them deal with them. That is really important to me, so I will be addressing it as well as how it has affected me as a debtor attorney.

In light of Cliff White’s comments this morning - some of these comments here are for mature audiences only. Parents, please bring your children out of the room. The new law’s proponents and supporters were wrong regarding their most important claims about the new law. They were wrong about the causes of large numbers of bankruptcy filings under the old law. They were wrong when they claimed that there was a problem and that it was the debtors’ fault. They were wrong when they claimed that many debtors could afford to repay their
debts but chose to file bankruptcy as a financial planning tool, the opportunist debtor that we heard about this morning and again mentioned this morning as being fairly small percentage.

The proponents were wrong when they claimed that the high number of bankruptcy filings was caused by abuse of filings that were allowed under the old law. They were also wrong when they claimed that the new reform law would prevent abuse of filings. They were wrong when they predicted that many debtors would not pass the new means test and would be forced into filing Chapter 13, instead. They were wrong when they implied that bankruptcy filings would drop because the new better-drafted law would keep frivolous debtors from filing cases.

It is true filings have been substantially lower, but, as discussed this morning, this is because of a lot of things. Because of debtor uncertainty about the availability of bankruptcy relief, it has dropped because of collection agents telling debtors that they cannot file bankruptcy anymore. And also we debtor attorneys having to completely retool our offices and completely learn a new law.

Filings, however, as we heard earlier today, are increasing and are anticipated to reach prior levels within a year. So, they were wrong about the ultimate outcome of that factor also. They were wrong when they claimed that high-
Roller bankruptcy debtors would be caught by the new law. Many high-rollers are not even subject to the new means test.

But most importantly, they were wrong when they claimed that the new law would not affect poor debtors. Supporters, proponents of the new law sold the Bill of Goods to Congress, and Congress bought it. Or, maybe it was the other way around; maybe the credit industry bought it. In any case, this Congress refused to listen to the experts who repeatedly warned of the many problems with the new law and those problems that have been borne out in its first year of implementation.

Now, let us look more closely at the effect on debtors and their attorneys. The vast majority of bankruptcy debtors do not have the ability to repay their debts. Many studies during the last 10 years demonstrated that fact, and nothing has changed because of the implementation of the new law. The evidences coming in, we heard that this morning about the credit counseling agencies and some of the information that they are receiving about the people who are seeking their counseling services and cannot afford to repay their debts.

Bankruptcy’s fresh start is still available to most debtors if the case is well-prepared by a professional who can make sure that all the “gotcha” traps in the new law are avoided. It is basically what they are, is “gotcha” traps. Many lawyers are offering free initial consultations for
debtors to make it available to them, and we are finding, of course, as was indicated previously, that most debtors have no problem passing the objective new means test. Poor drafting of the new law has resulted in many courts interpreting it in ways that still allow most debtors to obtain helpful relief. The new law has hurt the poor and the struggling middle class.

Again, this is what they said was not going to happen. It has happened; it happened by driving up the filing costs, increased court filing fees. For Chapter 7 the fees, as a result of the new law, went up from $209 to $299; for chapter 13, $194 to $274. The filing fee waiver that is much vaunted does not help much. Even debtors in social security often do not qualify for it. And judges, if they choose not to, they do not have to grant it.

Attorneys are a little afraid to spend the extra time that it takes to apply for it if they do not know it is going to be granted, and also they are not sure whether they can charge attorney’s fees or what the nature of their fees would be allowable in that case.

We heard earlier, mandatory credit counseling costs approximately $50. Later in the case, in order to get a discharge, the debtors have to pay a debtor education fee of about $50. So when you get finished, in order to get a discharge in the Chapter 7, for a poor or struggling middle
class person you have to pay $399; that is a 90 percent increase over the fee that was charged prior to the implementation of the new law. For Chapter 13, the total fee then would be $374, a 93 percent increase.

Of course, there are increased attorney’s fees. We have to live, too, and we are doing a heck of a lot more work on these new cases, there is no question about it. As well as the Chapter 13 trustee’s fees in many cases around the country, the Chapter 13 trustee’s fees are also going up.

The new law has hurt the poor and struggling middle class by increasing paperwork. The credit counseling requirement we talked about earlier, it is basically a needless barrier to bankruptcy for most debtors. Many unrepresented debtors’ cases are being dismissed for failing to file this; we heard about that also. But for me as an attorney, I think one of the most aggravating things is the burdensome and almost duplicative document production that is required, which does not help to detect fraud. Up to four years of state and federal tax returns or transcripts are required in Chapter 13’s pay checks. This makes me crazy, paycheck stubs.

First of all, you need complete year to date as of the filing date for the statement of financial affairs, and then you also need the 6th-month calculation of monthly income dollar amount. So you have got the pay check stubs that have to, at
least, bracket the beginning of the 6-month period and the ending of the 6-month period. Remember the ending of the six-month period is at the end of the prior calendar month, so your client may have some pay stubs after that that you have to pick up and report as a part of your year-to-date information on schedule F, as well as producing to the court or the trustees, depending on how they desire it, for the 60-day, for the 60-day period of pay check stubs also.

So, you have three similar requirements for pay stubs, and yet they are different, and it makes you nuts because these cases usually take a while to file and you have to keep having your client bring in the next pay stub. So that is just a little bit of detail there about how nuts these things can make you, even though that pay stub will not affect the CMI, whatsoever.

These document production requirements are very difficult for the homeless. You do not think we have very many homeless clients? Well, one thing that is a growing percentage of my clients are intermittently homeless clients, and these can be in a struggling middle-class. These are people who might have been out of work for a sufficient period of time to exhaust their unemployment benefits, but they had a decent job before. They are not mentally ill, they are not drug addicts; they are real people with real problems, and because they may have been
living in their car, they may not have all four years of their tax returns.

That then creates a problem for the IRS and the state-taxing agencies because if our clients do not have their tax returns we have to turn to the IRS and the state-taxing agencies to get them. And so I’m sure – actually, it would have been interesting to ask the gentleman at lunch if he knew anything about the burdens that were imposed on the IRS, which are significant, in producing transcripts and copies of tax returns.

Employers also are being burdened by this because if you are going back six months, seven months for pay stubs, if you are working for somebody, do you have your last seven months for the tax – or worth of pay stubs? Probably not. So a lot of our clients do not do this, so we have to turn to the employers. This is a burden on the employers, again for what purpose? The new laws hurt the poor and struggling middle class by complicating the process of analyzing the debtor’s case. For example, the new exemption limitations on the domicile changes, again, those are very, very bizarre in some cases.

At first, we thought that we were only going to have to be concerned about if the debtor had lived in another state within the recorded period of time would have to then learn what the
exemptions were for that state; but, even more intricate than that, we had to find out if they opted out of the federal exemptions. Did they opt out for non-residence as well as residence? So there is a whole new concept there that we had to get to the bottom of. Also, if debtors have claimed more than $125,000 in a homestead exemption, that threatens the conclusion of cases. It is very complicated if your exemption that you are claiming is over $125,000.

Disposable income in means test, again discussed earlier today - extremely complicated, nearly duplicative types of calculations required. The new law has hurt the poor and struggling middle class by reducing bankruptcy protections. For example, the discharged changes; tax discharged changes prevent many debtors from rejoining the ranks of normal taxpayers by filing Chapter 13. Recovering alcoholics, people who are recovering from long-term illnesses such as cancer or depression have gotten behind on filing taxes.

It used to be a way of getting people back into society and still paying their debts to society, and that is not as helpful anymore. New stricter repeat-filing limits are hurting debtors who are hit with uninsured medical bills within a couple of years of having filed the Chapter 7. And that, I’m saying more and more now, and it is really sad when people are desperate, financially, for no reason of their own - medical
bills, many of my clients do not have medical insurance. It is almost the rare case when they have medical insurance, unless they are actually employed at the time.

Cram-down changes, reaffirmation changes, a lot of these changes in the law, certainly intended to make it more difficult for debtors, and have succeeded to some degree. Largely, it is the uncertainty of the outcome with regard to cram-down and reaffirmation. The debtors are frightened of losing their vehicle, or willing to, as the case maybe, but certainly frightened.

And the uncertainty of where this poorly written law leads them is very difficult. Case dismissals for insignificant deficiencies, “gotcha;s,” they hurt the innocent debtor who re-files a correct case later but needs the stay extended. It was not a purposeful second filing; the first filing was certainly intended to be successful. But for the ignorance of the innocent debtor, the case was dismissed; it is an arbitrary and a punitive law with regard to needy debtors.

In terms of the impact on us, debtor’s attorneys, much more time is involved in preparing a case; I personally think, at least for my self, it is at least two or three times as much time as it took before. Attorney’s fees, it is difficult for debtors to pay the increased money upfront. We are looking at the court filing fees alone; I just ran through that. In
addition to that, they have to pay us something to do our work. Chapter 13, there is much more initial and long-term work that the attorneys have to do; and we, as their attorneys, are dependent on our clients for their long-term ability to perform as required. We have a problem sometimes later in a case locating our clients.

It is not uncommon to see them be intermittently homeless, and so it is difficult for us to locate all of their paperwork and to keep in touch with them later on during the case. There is much that the courts can do to make the system work more efficiently. They can adopt local rules as some have done to avoid the “gotcha” dismissals, to try to minimize the ways in which innocent people can be damaged by the new law.

They can simplify seemingly complex procedures by rules also, and they can assure that debtor’s attorneys’ “no-look” fees, if they have “no-look” fees in their area, are high enough to make it financially feasible for attorneys to continue to represent consumer debtors. That is very important because in the areas where debtor’s attorneys are not paid sufficiently then it makes it very difficult for them to have a Chapter 13 practice.

In terms of a general outlook for the future of consumer bankruptcy, definitely it will survive; filings will increase. Bankruptcies are driven by the economy and outstanding and
delinquent consumer debt. We know that. Many in this room know that. But it is very important to remember that this is the reason why bankruptcy filings increase. The public will become aware over time that bankruptcy relief is still available, and that will also drive the filings up. But, importantly, the new law is seriously flawed and demands substantial change. Thank you.

Lynn Tavenner: Well, Norma, we thank you for your perspective and your comments as a practicing debtor’s attorney. I suspect that Donald may have a little different viewpoint on that.

Norma Hammes: Sure.

Lynn Tavenner: Before we move to him, though, I’m curious about one thing you said; you were talking about the impact on debtors, and one of the things that you address were filing fee waivers. I’m curious as to whether you have had any success in using those.

Norma Hammes: I have, I have. In fact, I think if you look at the Northern District of California, I think it has the highest percentage of those waivers in the area, and I felt, oh well, maybe I’m responsible for that because I did actually file for waivers. But I had to do it carefully because I think I may have been the first in our area. I really did not know if I could charge anything for my attorney’s fees. Clearly, I
was putting a lot of work into this case. I felt very committed under the prior law. I did a lot of free cases myself. Now, it is fearful that under the new law I really did not know how it was going to work out.

Lynn Tavenner: So your courts have been receptive?

Norma Hammes: They have.

Lynn Tavenner: Good.

Male Voice: I think it is important to point out that the fee waivers are really only for very poor people, and I think I have heard it is like two percent of the cases in Chapter 7 where they are being granted. I know in our district, pretty much the only ones being granted are pro bono cases.

Male Voice 2: It is about two to three percent nationally, but locally, it is spotty. I think there are some districts and I think Northern District of California is one of the highest. It is up by seven percent, or so.

Lynn Tavenner: Well, Donald, is Norma completely correct in all of her comments and outlook on the new law?

Donald Walton: I’m not sure if I want to comment directly on her opinions. There are really two things I want to cover quickly, and one of them is one aspect of Debt Relief Agency, the DRA. I really cannot talk too much generally about DRA. This is after Section 109, the eligibility issues on credit counseling.
Probably, the Debt Relief Agency has been the area where we have seen the most litigation, the most activity; and the US Trustee Program, the Department of Justice, is either actively now defending, or we have concluded about 15 cases on debt relief agency. Now, unfortunately, all of them which have been concluded have been concluded on procedural grounds strictly. So we do not really have any final rulings substantively on many aspects of debt relief agency, in particular, whether an attorney is a debt relief agency. But one aspect of it that we are comfortable with is that pro bono attorneys are not debt relief agencies.

Under the statute, in order to be a debt relief agency, you must have accepted money or other valuable consideration. We believe that the pro bono programs that are operated throughout the country by bar associations and other outfits, there is no money paid.

The other variable consideration of us as lawyers feeling good in all this is not what is envisioned in the statute, and we will not bring any actions against any attorneys who are operating pro bono. We would encourage, and we continue to encourage, all attorneys to participate in those activities because they are good activities and they have helped the system significantly. The other area that I would like address real quickly, because it is a brand new area and will affect
attorneys in how you counsel your clients and what will be required of your clients. That is a debtor audit.

And as Cliff I think mentioned this morning, debtor audits will start for all cases filed on or after October 20th, so I think that is in about four days. And we will be conducting them in all areas except for non-UST states in North Carolina and Alabama. Essentially, Section 603 of the BAPCPA requires the attorney general to establish procedures to determine the accuracy, veracity, and completeness of the petition, of the schedules, and any other document required to be filed by Section 5-21.

So, consequently, we will be looking at the petition and schedules, the Statement of Financial Affairs and the forms, depending on if it is a 7 or a 13. I believe what this will give us ultimately is some indication of to what extent there is fraud and abuse in the system, because, heretofore, we have had nothing but anecdotal information. This will give us a baseline as to where we will be.

Any Chapter 7 individual debtor, any Chapter 13 debtor is eligible to be audited. We will take the position that a Chapter 11 individual debtor who converted to a Chapter 7 or converged to a Chapter 13 also would be subject to being audited. We are required to audit one out of every 250 cases filed in any particular district. We also will audit those
with excess income or expenses greater than the average variance from the norm in a particular area.

I think Cliff mentioned this morning that we anticipate, in fiscal year 2007, we will be conducting approximately 7,000 audits that will be done by independent CPAs. We went through a competitive bidding process; we have selected six firms to do the audits. We have, actually, the country divided up into 10 regions if the county – excluding North Carolina and Alabama, but nine regions. Six audit firms – there will be two audit firms per region. So if any of your clients, if you are filing in the same area you will be subject to being audited by one or two audit firms in your particular region.

Generally how it will work is that we will make a case selection; the audit firm will be notified and assigned. The US Trustee office will be notified and will send out a letter to the debtor’s lawyer or to a pro se debtor, saying the case has been selected for audit. The debtor will then provide the audit firm with the documents requested. The audit firm will complete its audit, file its audit report with the court, and then US Trustee program or any creditors can take any action if it is appropriate.

We envision this whole process to take about 70 days from the date the debtor is notified of the audit. The debtor will be notified of the audit almost immediately upon filing of the
schedules and the statement of affairs, because that is what we will be auditing; we will be auditing the schedules and the statements of the affairs as originally filed with the bankruptcy court.

What will happen is the letter to the debtor’s attorney will include the notification of debtors and audit, it will include the documents that are going to be required to be sent to the auditors. It will include the auditor’s name, obviously, and there will be a general instruction sheet to the attorney to be handed to the client if the attorney wants to advise the client as to the whole audit processes, what will be done. Also, in that pack that goes to the lawyer, and there is a point there will be a release form.

We will not, and our auditors will not, communicate directly with a represented client with respect to the audit unless the attorney has signed a release form, and it is strictly up to the attorney. We do this fairly regularly in Chapter 11 so we can talk to debtors directly about financial matters. Some attorneys would prefer us to talk directly to the client. We will not do it. It will be the auditors so that they do not have to be a part of the process in taking responsibility for - some attorneys will not want to sign that letter, and they will want all communications to go through the attorney - that is up to the attorney.
The documents to be required are going to be similar to the documents that already need to be gathered together by the attorney in order to file the case, initially anyway. Six months of pay stubs, the pay stub six months prior to the filing of the case. Six months of account statements and bank accounts or brokerage accounts or any kind of financial account into which the debtor has, six months of those statements. Federal income tax returns, only two years of federal income tax returns prior to the filing.

And then the last one, which is a little bit different, are divorce decrees, property settlement, child support orders which have been entered within three years prior to the filing. The debtor will gather all those documents, either forwarded to the attorney to forward it on to the auditors or forwarded to the auditors directly.

Then what the audit firm will do is determine the accuracy, veracity, and completeness of the bankruptcy documents filed by the debtor; the audit will be a desk audit. The auditors will not come to the debtor’s house, will not have any personal contact with the debtor; everything will be done by the auditor from the auditor’s desk, wherever that office is.

What the auditors will do will be to form searches on the internet of public records, and they will compare those
searches, what the auditor finds in those searches - Choicepoint, Autotrack, Nexus/Lexus, courthouse records, any of the various records which are online and are public, the auditor will search those, compare those with what is on the documents which were filed with the court to determine the accuracy of those, to determine whether it appears any assets were not disclosed.

If the auditor finds something that is either a material misstatement or other item of interest, they will then allow the debtor time to explain it. Oftentimes, it might be a piece of property that will appear that is in the debtor’s name. Well, it may be a name of a similar - it may be that the debtor had sold the property previously, it may just be a mistake. 

The debtors will always have an opportunity to explain whatever findings the auditors will have. The idea is that the audit firms will identify material misstatements. So once they find a material misstatement, then as part of the explanation they will get an affidavit. If it is not responded to satisfactorily to the auditors, they will file a report of audit.

Now, the report of audit, if there is a material misstatement, will be filed by the auditor and it will state what that material misstatement is. That document will then be served by the clerk of court on all creditors. The auditors
find no material misstatement; it will just be a report filed “audit completed, no material misstatement.” Or the auditor will file a report that says, “Audit could not be completed because sufficient records were not provided by the debtor.” Those are going to be generally the three items that will happen.

Once the audit is filed, if there is a material misstatement, the statute requires the United States Trustee either to take appropriate civil action or, if appropriate, file a notice with the US attorney, and make a referral to the US attorney if there appears to be have been criminal action. All this is being done within first 70 days, but we anticipate that by the time we get ready to take action, a discharge might be entered in a Chapter 7 case, which is normal, and the statute contemplated that we can file a motion or an advisory to revoke the discharge.

We believe we can file a complaint objecting to the discharge, we might file a motion to dismiss in a Chapter 13 case, we might object to confirmation, we might ask for a revocation of confirmation. A Chapter 7 trustee, if there is an asset to be found, may file an action to seeking return turnover of any estate property that was not properly disclosed. Then we also might file a motion to compel those to cooperate.
We believe that remedies are available if a material misstatement is found by the auditors. And if there is failure of the audit because we have not been able to get documents and also the possibility of actions against the lawyers for failure to keeping their client up to date, and having their client provide documents.

Henry Sommer: Let me just ask you a question about the audits. What is the United States’ position if the debtor does not have particular documents that you requested? For example, I think you are asking for six months worth of bank statements; not only that, but an explanation of every check or withdrawal. What is your position if the debtor does not have that?

Donald Walton: We are not asking for an explanation; we are just asking for the statement itself, and the debtor will be able to explain it. And if there are valid reasons why a debtor does not have the pay stubs, does not have the document, that will be taken under consideration.

Henry Sommer: Okay. Well, let me just talk a little bit about the experience of the debtor’s attorney. I think that experience is varying around the country because it depends a lot on the court, the judges that the debtor is dealing with, United States trustees, or bankruptcy administrators, and the trustees that the debtors are dealing with.
I would say you could probably class the approaches to the new law in three classes. As I suspected, even before the law went into effect and especially in Chapter 13, there is a certain group of judges and trustees who want to pretend nothing has changed and do things just the way they have done it before. And some of these cases that you see that have just totally thrown out, ignored, the definition of disposable income in Section 1325(b).

These courts say, “We are just going to look at schedule I and J, just like we did before.” It is hard for me to conceive how you can adopt an approach like that that basically takes this whole scheme that Congress has devised and says it is either a starting point that we can then disregard or we are not even going to look at it, but there are some that take that approach.

A second approach is, well, we know Congress wanted to harm debtors, so even if it does not seem like the statute exactly does it, if you look at the language, “well, we are going to do it anyway.” And there are some examples of that as well. For example, Section 521(a)(6) is one of the statements of intention provisions. It talks about allowed claims. Some courts will say, “Well, we are just going to ignore that word ‘allowed.’” Congress did not really mean it.
And then there is a third group, I think, certainly, among the judges, the majority of whom were trying to make sense of the statute, trying to keep the system working reasonably and control costs, and there are number of decisions along those lines as well. Especially, I do not know if it is a coincidence or not, in North Carolina where there is no United States Trustee. It seems to be a place where a lot of more reasonable approaches are being applied.

And then I have to say that a lot of the problems, I think, that debtor’s attorneys and debtors are facing are because, for the most part, and this is not across the board, the United States Trustee Program is taking the second approach; they are really not considering cost. They are engaging in “gotcha” motions and they really have taken it upon themselves to act as an arm of the consumer credit industry, with a mission to keep people out of bankruptcy court. This is somewhat filtering down to the Chapter 7 and 13 trustees—that this is what is expected of them.

I’ll give a few examples: I have a debtor in Florida who does not speak English. He speaks Creole, and the judge decides to waive the credit counseling requirement because the debtor cannot get it in a language he understands. The US Trustee is fighting that tooth-and-nail, asked for reconsideration, and I think filed an appeal.
We had a case in Pennsylvania where the debtor was about ten years old, and, I guess, had title to properties. So, through a next friend the child filed a Chapter 13 case, and the Chapter 13 trustee came in, I’m sure doing what he thought was US Trustees’ bidding, argued that it was not enough for the next friend to do the credit counseling; the 10-year-old debtor had to go to credit counseling.

There are other cases where I have heard, U.S. Trustees have filed motions where some have gotten credit counseling a little bit outside the 180 days. And in other cases trustees, again, saying they are trying to do what the US Trustee asked them to do, have moved to dismiss cases because tax transcripts were filed a couple of days late.

These are the kinds of things where courts have been asking U.S. Trustees, sometimes in opinions, to exercise what was mentioned, prosecutorial discretion. I mean, the bankruptcy system ought to be something that is looking at doing justice. If there is a mistake that does not make any difference to the outcome of anything, why in the world are we paying government agencies to spend all this time trying to get people out of the system? And this is causing debtor’s attorneys, also, to look over their shoulders, to be afraid of these “gotcha’s,” of the nitpicking.
Just another example, we had a case in our pro bono program where the debtor is probably one-quarter of the median income, at best; and someone from the U.S. Trustee’s Office calls up and says, “We do not think you filled out the means test form correctly.” No matter how you filled out the means test form, this debtor was not going to even be close. Is it that they have to — the bureaucracy, they have to kind of find things to do, justify their own existence?

It sort of makes you wonder — and I’m very concerned about these audits. I asked that question because the U.S. Trustee, all they are saying, “Well, we are asking for documents that the debtor’s lawyer ought to already have.” Well, actually, they are asking for documents that go beyond what is necessary to complete the forms. I’m afraid that they are going to try to basically create this perception that you have to obtain these documents in every case to be prepared for an audit.

It was interesting — we had a speaker from the IRS today because I would contrast what people are now trying to do to bankruptcy debtors to what happens to taxpayers. Up until recently, we had a bankruptcy system that basically allowed people to verify things and sign and say, “This is the truth.” Now, basically, we have a system where people are not being trusted to tell the truth and they have to provide all of this
documentation as if this there is a presumption, almost, that consumer debtors are somehow dishonest.

At the same time that the United States Trustee Program is devoting very little resources to going after non-consumer individual debtors, and I think most people in the bankruptcy system know, there is probably heck of a lot more abuse in those cases, and just about no resources at all to going after any kind of abuses by creditors. It has taken bankruptcy judges to find, for example, and debtor’s lawyers to point out, where creditors were just making up things for fee applications on stay motions. There were creditors just making up things for the affidavits, using pre-signed affidavits on stay motions.

There is a double standard where the United States Trustees Program is concerned. Although debtor’s lawyers ought to be looking at every shred of documentation for the papers they file, it is perfectly okay for creditors to file proofs of claim based on computer-generated numbers that nobody ever reviews. They do not attach the documents required by the rules because some people think it is too burdensome to actually ask them to comply with the Bankruptcy Rules. In fact, in a letter to the House Judiciary Committee that just came in pretty recently, in contrast to the thousands of debtors and debtor’s attorneys that the US Trustee has filed
actions against and investigated, I think they made something like three or five inquiries into creditor practices. They did not even keep statistics before this past year, but there is basically no oversight of the creditor side.

So I think the agenda here, which, unfortunately I think the United States Trustee Program has bought into, to a large degree, is a kind of quasi-criminalization of debtors, and really that goes to what some people were saying about Section 707(b)(4). The way I read 707(b)(4), bankruptcy lawyers have basically the same duties as other lawyers; it is basically Rule 11, Rule 9011, reasonable investigation. It is not “document every single thing.”

In the materials you’ll find the American College of Bankruptcy Committee’s best practices for consumer debtor lawyers, which pretty much is premised on the idea that you can believe your client, just like any other lawyer can believe their client, unless there is some reason to suspect that what you are being told is not the truth. I’d like, also, to say a couple of words about the debt relief agency provisions and why those provisions, if they are applicable to attorneys, which, I think, is still an open issue, can cause problems.

Of course, NACBA along with the Connecticut Bar Association, has filed a lawsuit in Connecticut saying, number one, they do not apply to attorneys. To the extent they do,
they are unconstitutional in a number of different ways - they limit the advice attorneys can give to their clients about lawful actions; they require compelled speech of disclosures that are inaccurate, incorrect, inapplicable to the clients. They require attorneys to enter into a contract with a client within a few days after even just giving advice, which impairs access to the courts for disabled people, people in rural areas, just people who - a lot of attorneys, just to be safe, will not talk to someone unless they talk to them in person.

And, finally, they require this advertising that “We are a debt relief agency,” sort of creating a misimpression that maybe you are an agency of the government, or something else and would lump attorneys together with petition preparers. It is kind of interesting if you read our brief and the United States Trustees briefs in the materials. It is kind of interesting, if you read the United States Trustees’ brief because they basically tell the court to ignore many parts of the statute that, “Well, yes it says that, but we are not going to read it that way, we think it only applies to debtor’s attorneys,” even though it does not say that. “We think it only applies to incurring debt to game the means test and not any other kind of debt.”

So it is kind of an admission that the provisions are terribly drafted, but it is a problem because it does interfere
with attorneys’ relations with their clients. Yes, there are ways around it; yes, you could tell your client, “Well, if you were to do this, this is what would happen. If you were to incur debt. This is what would happen. I cannot advise you what to do.”

You can play that. Sort of like, again, like a criminal lawyer talking to a criminal defendant. But attorneys should not be put into the position of doing that; they should not be put into a position of saying, “I have to give you this disclosure, but it is inaccurate. This is inapplicable to your case.” It creates all sorts of impositions on the attorney-client relationship and sort of creates this message that bankruptcy clients are different, bankruptcy attorneys are different than other attorneys. And, basically, I do not think that serves well a system that ought to be interested in relief for honest debtors in an efficient, cost-effective way that gets a fair result.

So depending where they are, I think some debtor’s lawyers do feel they are under siege a little bit. I hope that most courts will impose some reason on the process; I think they have to some degree, already. And I would like to hope that the United States Trustee would back off on some of the “gotcha” provisions. I do not know if that is possible until
we have a change of administrations, but we will have to see. But that is sort of my hope about where that will go.

Lynn Taverner: Well, Henry, we appreciate your comments. It sounds like, in some specific and discreet cases that you brought out, you identify that there are some issues. Perhaps, another year down the road we will have some more empirical data and we can determine whether, in a global sense, the scope of these concerns. I would like to say, though, that I’m a panel trustee. And notwithstanding the fact that I do not get completely compensated for everything that I do, I try to do what the Bankruptcy Code, the bankruptcy rules, and the local rules require of me now.

And I look to those things and the courts for guidance, and I do not have the office of the US Trustee in my district breathing down my back. It could be different in other places, but I did not want to make that point. And we have a few minutes left so perhaps, Donald, you wanted to respond to him -

Donald Walton: It is very difficult to respond to anecdotal evidence because everybody always has a horror case out there. For instance, the case in South Florida, there was a case in fact where counseling in Creole was available, and it did eventually settle the case. The other case that Henry talked about did settle with the intervention of the US
Trustee. So I do not really want to get into anecdotal, into horror cases; they are always out there.

I notice one of the problems with bankruptcy policy, generally, that it has always been developed through the use of anecdotal evidence without the real empirical evidence; I know Cliff talked this morning about data tags in trying to decipher some of the forms on the information so we that we can actually get some real evidence, and I think the debtor audits will also provide some of that evidence.

And I also agree with Henry in a couple respects. One is that bankruptcy is a self-reporting system just like the IRS. Just like when we pay taxes to the IRS we file, we report our income, it is unverified, and we just sign on the dotted line.

The same thing happens in bankruptcy - when we have our taxes we are subject always to be audited and if one of our returns is audited, then there is some extra paperwork that is required. The new debtor audit is going to be no different. The vast majority of all debtors are honest; the vast majority of all debtors do properly report their information, but there has been never any systematic rule in place to be able to verify exactly if there is fraud out there or if there is abuse of the system.

We have never had the ability to be able to go back behind what the documents show. We now have that ability. We will be
able to find out that evidence, and hopefully it will be as Henry suggests, that there is very little fraud out there. We do not know we do not know how much is there; we do not have any baseline information with respect to that.

The other thing that Henry did say that I do agree with is that bankruptcy lawyers are just like other lawyers. They are not held to any higher standard now than they were prior to the enactment of the statute. It has always been there that they need to complete the job; they need to ask the right questions to their clients. They need to be able to gather the proper information so that they can properly advise their client as to what type of bankruptcy to file and as to whether the schedules are completed properly.

It was that way before BAPCPA, it is that way now. It is the same, whether you are practicing bankruptcy law, tax law, or personal injury law. You need to be able to question your client to ensure that you have the information so that you can do your job. That is all the new provisions of the statute say, is that lawyers should be there to make a reasonable inquiry, because, unfortunately, we found, prior to this statute that many attorneys do not.

Lynn Tavenner: I thank the panelists for their presentations. Are there any questions? Yes, Larry?
Larry: Normally, I’m very sympathetic to your point, Norma. I know you do a very thorough job in your practice, but your comments do present this question, and that is if all of these documentation requirements are now new to you and your clients and they knew the expense of gathering them, what documents did you rely on prior to this law in filing bankruptcy cases?

Norma Hammes: Well, that is a good question, and let me tell you just a little bit about the paycheck stubs that I mentioned. Under the prior law, I did get copies of paycheck stubs, but exactly which ones I got were less important than if I felt, by looking at a combination of them, I could see a trend or an average situation.

That is not the case anymore. You can see exactly where your clients are with regard to the paycheck stubs that I would have asked for, previously, but those are not the ones that are required. There is a whole mixed bag, as I mentioned before, of additional pay stubs that do have to be collected. That is a good example.

Lynn Tavenner: Any other questions?

Male Voice 2: Pardon me for not standing. Mr. Walter, how much are the auditing agencies getting paid for each audit, and where are those funds coming from?
Donald Walton: I do not know the answer to your question. I have seen the audit contract and I have reviewed it, but I cannot give you an idea. The funds are out of the US Trustee Fund as part of our appropriation. So the United States Trustee System is paying for the audits.

Lynn Tavenner: Right here in the middle.

Male Voice 3: Before BAPCPA, and reaching to the Northern District of Indiana, as a Chapter 7 trustee as well as a debtor’s attorney, we always would get tax-returns for at least two years and also part of payroll stubs, just to substantiate income. That is - I found it somewhat unusual that it was a requirement now because we have been doing it before, the last three or four years.

Henry Sommer: Well, the local rules are varied. Obviously, my answer to that question that Larry asked is you get the documents that are reasonably available. If you have a pay stub that has a year-to-date figure on it, or if you have a W2 form or something, that gives you a pretty good idea of the debtor’s income.

You might have a tax return; you might have something else. But in most districts, you did not have to provide these specific 60 days of pay stubs or these particular years tax return or tax transcripts are now demanded a couple of years
going back for the audits. So I think it is the inflexibility of the requirements.

And some courts, a few courts had local rules that were very onerous and I think overly onerous before. And some trustees have attempted to require more documents, and sometimes they have been successful and sometimes they have not.

Male Voice 3: I feel like there was so much anecdotal reporting in this new law because they were saying that people could keep their million-dollar homes, and I was thinking about Indiana until July. It was a $7500 homestead exemption until it came up to $15,000, and Congress saying, “Well, people, we have to change the law because folks can keep the million-dollar homes.” Not in Indiana. That was anecdotal.

Lynn Tavenner: I think we have one more question.

Male Voice 4: Question for Henry. You invoke 707(b)(4) which dangles Rule whatever or 9011 in front of the lawyers, and you thought this was a scary thing, but …

Henry Sommers: I do not think it is a scary thing. I do not think it really changes things very much, if at all.

Male Voice 4: What aspect of Rule 9011 is that the opponents —I guess the US attorney — have to file a motion with the attorney who then has 30 days to withdraw the motion if
there is any error? So does this not amount to an error-correction thing?

Henry Sommers: Well, actually, Rule 9011 has an exception for the petition itself where you do not get the 21 days safe of harbor.

But my view of 707 (b)(4) is it pretty much just incorporates the same standards as Rule 9011, so I do not think it really changed things as much as some people seemed to think. You have to make a reasonable inquiry. You have the same duties that any other attorneys have.

Judge Dow: I would like to thank the panel for the presentation. We will take a break now and reconvene at 4:15 for our final panel on bankruptcy rules.

[End of file]
Dennis R. Dow: Let us go ahead and begin. We are in a homestretch now and we will save a little time at the outset because the moderator of this panel needs no introduction. So I will introduce the panelists instead.

To my far left is Eugene Wedoff who is the chief bankruptcy judge in the northern district of Illinois. And to my immediate left is Chris Klein who is a bankruptcy judge in the eastern district of California, and they are both members of the Rules Committee which is fortuitous because that is what we are going to be talking about during this last panel.

I’m sure you are aware of the fact that it is pretty obvious that because of the substantial changes to the code, changes were required to the bankruptcy rules and forms as well to accommodate some of the new proceedings that had to take place, some of the new information that had to be filed, and some of the new data that had to be collected pursuant to the act.

And as you know, the Rules Committee worked extremely hard in a very short period of time to prepare interim rules that would be proposed for adoption by local courts by local rule.
One of the reasons for that was because, as Gene will talk about, the ordinary rule making process can extend out for a period, as long as three years. So there simply was not enough time to promulgate rules that would take effect pursuant to that process.

And the Rules Committee, on looking at the statute, had to because of some awkward and difficult drafting in some places, make some decisions as to what some of these things meant, and what kind of disclosure would be required, and what sorts of rules and forms would be appropriate. And I think that the Committee has done an excellent job of crafting forms that would make the process work and that are for the most part substance neutral. But there are some questions about some of the provisions, what they mean, and why particular choices were made, and whether other arguments can be made about what the form might say pursuant to an interpretation of the statute. So we are going to look at some of those questions.

But to start off with, Gene, I’m a faithful reader of my core proceedings newsletter which is sent to me every month by the administrative office. And in this addition, there were no less than three different articles on various rules in various stages of formulation: First, the set of rules that is going to become effective December 1, 2007 if Congress does not act to the contrary.
Second, an amendment to one of the interim rules that we have adopted and a new form which becomes effective because the form does not have to be approved October 1, and then of course the rules which were originally promulgated as interim rules and it is being re-promulgated and revised pursuant to the permanent rule-making process and will be up for comment until February 15, 2007.

And Judge Klein was just showing me the volume which you can display here, which was just published I think today. So this is an extremely timely panel because you have the opportunity now to review these and provide comments on them during that period of time.

Eugene Wedoff: It is about 3.2 pounds of light reading.

Dennis R. Dow: So Judge Wedoff, why don’t you start by talking to us briefly about the process and where we are in that process which we expect to some of these rules, and then we will take a look at some specific examples.

Eugene Wedoff: Okay, I really want to do that. In fact as Chris and I have planned this, we want to go through the usual process for adopting rules and forms. We want to talk about the process that we used for BAPCPA and then we want to go through five different rules and forms to illustrate the approach that the advisory committee and bankruptcy rules has taken.
But before I do that, let me emphasize that the Rules Committee in bankruptcy has a peculiarly difficult job. The rules enably act at for all the other rules - evidence rules, PO rules, rules of civil procedure - those rules are said to be able to trump the substantive statute that they are implementing. If there is a difference between the procedures set out in the rules and a procedural provision that might be in a statute, the rule governs.

The exact opposite is true in bankruptcy to the extent of the Rules Committee adopts a rule, it is proposed and enacted that is contrary to the statute. In our case, the statute controls over the rules, so we have to be extraordinarily careful not to violate any of the procedural requirements of the rules itself, and that is for any bankruptcy rule.

But let us talk about the normal process. As Dennis had said, it is three years. In year one, the advisory committee comes up with ideas for bankruptcy rules often suggested by practitioners, we send those to the standing committee that governs all the committees that govern rules, and then finally after the standing committee reviews the proposals from our committee, it goes out for public comment. And that is the situation that Chris is showing you right now exists with respect to the bankruptcy rules.
In the second year the advisory committee looks at all the comments and the results of any hearings that have taken place on proposed rules, gives them again with any changes that are made in light of those comments to the standing committee for their review, and they send it to the judicial conference which hopefully approves the proposal.

Then in the third year, the rule finally goes to the Supreme Court for adoption. The Supreme Court, having adopted the proposed rule, transmits to the Congress where it will become effective unless Congress enacts a law to nullify the effect of the rule; so a three-year process ordinarily. Forms are a two-year process because there is no need to go to the Supreme Court or Congress.

If the standing committee likes the suggestion from the advisory committee, it could adopt an official form immediately. Usually though, the official forms go out for comment, too, and then in the second year the comments are reviewed, goes to the standing committee again, and then to the judicial conference for adoption of the proposed official form; a two-year process.

Now with BAPCPA, this process obviously could not be followed. The law was signed by the President in April and between April and October 17 of last year, when it was going to become effective, there was a need to adopt rules that would
enable the law to be administered, forms that would allow for
then administration with no time for the three-year process.
So what the Rules Committee did, as you know, was propose
interim rules that would be adopted either as standing orders
or emergency local rules in each of the various local
districts. That, in fact, was done with the approval of the
standing committee and official forms were adopted again on an
emergency basis.

Then in this year, 2006, we started the three-year formal
process with respect to those interim rules. We looked at the
interim rules again in March, proposed them with the one
changed that Dennis had mentioned, which is the change to the
petition to bring into play these warnings about credit
counseling. That is the new attachment D to the petition that
requires the debtor to acknowledge the need to get pre-petition
credit counseling before the petition is filed. We hope that
it will cut down on unnecessary dismissals.

That is in effect right now. That official form went into
effect that October 1 and the rules being adopted is in the
interim rule by all the courts. And then in June, the standing
committee approved the new forms and set out a package of
interim rules, the complete package for comment. And as Dennis
said that comment period is running right now.
One February 15 of next year (2007) the comment period will close and in March the Advisory Committee will meet again, consider all of those comments, and decide what changes are needed to the interim rules and forms. Next September and June, the standing committee and the judicial conference should give us their approval of what we proposed, and then in April of 2008 the Supreme Court would adopt the proposed rules we hope, transmit them to Congress, and finally, December 1, 2008, we will have no longer interim rules but final, official bankruptcy rules together with the official forms.

Christopher Klein: Let me jump in and point here on these comments due February 15, there also could be hearings right about that time. And with respect to the comments, I urge you, review these and send your comments. If you look in our written materials right near the end of them, there is an article from the Practical Litigator regarding public comment in the work of federal rules committees. It is a very good summary of the process, and how you send comments, and what kinds of comments are particularly effective, how to structure and then do it. So if you are thinking about a comment, please take a look at that.

Eugene Wedoff: Chris reminds me to tell you what is actually in the materials. What you have is a summary of the entire set of rules that are up for comment. We’ve got a
summary of those rules, and then we have all of the means test forms if you want to look at those, although I have to say unfortunately it is in the old version. The new version of the means test forms which were required to be used as of October 1 has slight wording changes. It also makes it clear that all debtors are required to fill out part 3 of the Chapter 13 means test form, and I’m not going to give the reasons why that is the case.

Christopher Klein: You are getting letters from the legislators?

Eugene Wedoff: No, that is not the last thing. After the suggestions that Chris just told you about, you also have Lewis Munford’s very good article on how to make rules comments in a letter that was received by the Chief Justice of the United States in March of this year, where Senator Grassley in sessions raised an issue about one aspect of the means test forms that I’ll get to in just a second. But what we want to do now is give you some idea of the approach that the Rules Committee has taken to trying to implement BAPCPA, and basically there are four points to that approaches as I see it.

First of all, and most importantly, we want the war to work; we are adopting rules and forms to try to implement the law effectively.
Secondly, we know there are going to be a number of debatable issues. You heard all day today about issues on which the courts and parties disagree in interpreting BAPCPA. Wherever possible the aim of the Rules Committee is to be neutral; not to try to decide those by rules and forms but to allow the issues to be raised effectively and be decided by the court.

Three, wherever a choice had to made, where there simply was no way to be neutral, we did our best to give the best reading we could to the debatable propositions.

And then fourth, and also very important, here following on what Chris said, we want to be humble. We want to recognize that given the speed with which these interim rules and forms have to be adopted, we were not going to be perfect.

We are quite confident that there are ways in which our work can be improved, perhaps substantially. And that is why we really want to echo what Chris said, please give us your comments wherever we have been ambiguous, wherever we may have contradicted the statute, wherever we have adopted a procedure that is not as efficient as it could be, we need to hear from you.

And with that we will talk about some specific examples about rules and forms that we have adopted to show how we try to put those four points into effect. We will talk about
better education, Chris will do that; the means test forms that I’ll talk about; a new provision of the code Section 342(g) and how we implemented that; reaffirmations and small business Chapter 11 cases are what we are going to want to cover.

So Chris, let us go to Rule 1007 C, and better education is our first example.

Christopher Klein: You noticed how he teed me up here. He talked about making mistakes, and the first thing he wants me to do is confess error. And I’m afraid I have to confess error in a way that shows how the process worked and how it was less than perfect, and then identify a mistake that we now think was made. A rule, as you know, a requirement to get a discharge on both Chapter 7 and chapter 11 now is that there be a financial education for the debtor obtained after the petition, and you do not get your discharge until you follow the paper.

Well, the statute did not specify a deadline for it. There were a lot of practical administrative reasons why there needed to be some kind of a deadline; otherwise, cases could just set open for a very long time. It would be a way for a cynical debtor to extend the effectiveness of the stay for six months by, say, not filing it, that kind of thing. And so we decided that for practical administrative reasons, there needed
to be a deadline for filing these financial education statements.

The approach we took was, well, no problem if the case is closed without a discharge, which is what, would happen; the case could be reopened if the debtors wish to file financial education statement to be reopened and the debtor could obtain a discharge. Not a very elegant way to go but it was just one those decisions that we had to make. Now, we fixed this deadline and rule 1007(b)(7) and the actual deadline within 45 days after the first dates set for the meeting of creditors under Section 341.

But then in (c) in 1007(c) we have provision relating to all the various deadlines that are ruled in rule 1007, and we lumped all of the financial education deadlines in with the group of deadlines that can only be extended on motion for cause shown. Well, the usual cause is stupidity, sloth and something that you really have a difficult time accepting as cause with a straight face.

Male Voice: It is not excusable.

Christopher Klein: Neglect, but not excusable neglect. It is not a basis to deny a discharge; it is just a pre-requisite for a discharge. And the mistake is that we should not have required the showing of cause. Now some courts have pushed the cause issue, others have just noted it.
On the Rules Committee, our solution to it was to note it as one of those things that in the normal three-year rule making process will tag as needing to be fixed, and in the interim will just be public that we think that the showing of cause was not what we really meant. And I’m unaware of any case where somebody is refused to reopen to extend for not showing cause but there are judges out here who have certainly raised the question.

Eugene Wedoff: You know, I should say that reopening a case that was closed without a discharge is something that the judicial conference really wants to encourage because there is a new filing fee that is required whenever the case is reopened, and that could be a big money maker for the judiciary.

The next point that we want to talk about is probably the one that has raised the most concern, the means test forms. And here I can only give you three small samples of the many issues that the Rules Committee had to deal with in adopting forms for means testing.

Just so everybody knows, you have already heard it, Section 707(b) now creates a presumption that a Chapter 7 case filed by an individual with primarily consumer debts abuses Chapter 7 if the debtors’ “disposable income” - I put that in quotes because it is not actually in 707 (b) - this is the
debtor’s income less living expenses and payment of priority and secured debts, if that disposable income exceeds a threshold that is specified by the statute. And the means test is what measures disposable income for the means test purpose. So that is what we are talking about - a mechanical test to generate a presumption of abuse in Chapter 7.

Now the means test is also used, as you heard, for some purposes in Chapter 13, generally to determine the disposable income of debtors in Chapter 13 whose income is above the median. But the means test has three points: it measures the debtors’ income, that is, current monthly income, the six-month average before the filing; it deducts living expenses; payments for security and priority debt, and then compares that result, income minus these deductions to the abuse threshold. If the debtors’ disposable income exceeds the abuse threshold there is a presumption of abuse.

Now, importantly, and this is something that Professor Carlson asked about, there is a safe harbor 707(b)(7) that provides that no one, no judge, United States trustee, bankruptcy administrator, let alone creditors or other parties in interest has any standing to bring a means test presumption motion if the debtor’s income is below the applicable median.

And as you heard Mark Redmiles say, that for this purpose the debtor’s spouse’s income is included even if it is not
contributing to the support of the debtor or the debtor’s dependents on a regular basis, unless they are separated. But in any event, the 707(b) safe harbor means there cannot be a means test presumption motion presented if the debtor’s income is below the median.

There is a similar safe harbor. The means test is not used to calculate disposable income in Chapter 13 if the debtor’s income does not exceed the applicable state median. So let’s ask three means test questions. Do the debtors have to be above the safe harbor, and above the state median to go through all the deductions that the means test requires – the deductions from the IRS are standards and the deductions for security and priority debt – or is it enough for them to fill out the income portion of the means test to show that they are below the median, and therefore no one can bring a means test motion?

The second question is, what do you do with unemployment compensation? Is that income for purposes of the means test? And three, the one that the prior panel discussed, are the ownership costs of a vehicle deductible even if there is no lien on the vehicle, even if the debtor owns the vehicle free and clear?

Those are three questions that the rules committee had to decide and what they do is show this difference between areas
where we could be neutral and areas where it was not possible to be neutral. Well, first of all let me say, either the debtor fills out the complete means test form, all six pages, or the debtor only fills out the first page and a half that deals with income.

There is no middle ground; there is no way to be neutral on this point. You have to make a decision; do they have to fill it out or not? The relevant portion of the statute here is 707(b)(2)(c), which requires the debtor to fill out a means test form. As part of the schedule of current income and expenses, the debtor should include a statement of the debtor’s current monthly income; that is income for the means test, and the calculations that determine whether a presumption arises.

That is the key phrase, “calculations to determine whether a presumption arises.” Since no one can bring a means test presumption motion if the debtor’s income is below the median, the Rules Committee determined that the debtor should not have to fill out the deduction portion of the means test if their income is below the median. In other words, going through the calculations that the income section of the means test requires here on part line 15 of the form, you compute your income under the means test, you compare it to the state median, and then make the calculations as to whether your income is above or below the state median. If it is below, the means test form
directs the debtor to go to the end of the form, sign it, and turn it in, check the box that no presumption arises.

Male Voice: Do not collect $200 dollars, do not go to jail.

Eugene Wedoff: Exactly.

Christopher Klein: But we are not changing the law. So if the law is that we got it wrong, it is up to whoever does not like the way we did it to litigate and get judicial determinations of what the law is. And that is true of basically all of the choices we made along the way.

Eugene Wedoff: Or the alternative is to comment; and as I indicated, Senator Grassley in sessions has commented. They believe that the direction to the debtor not to complete the form if the debtor is below the state median income should be changed to require all debtors to provide all that information because there is no exemption from information filing.

Now that is simply a debatable interpretation of the statute, and comments on these, either pro or con, are certainly welcome by the Rules Committee, but you can understand we did have to make the decision there; there is no way to be neutral. Now in contrast, unemployment compensation is one where we could take a different approach. The definition of current monthly income for purposes of the means test set out in Section 101 (10)(a) of the code now has in
addition to the income that the debtor actually receives in the six calendar months prior to bankruptcy.

Also, any amount paid by any entity other than the debtor on a regular basis for the household expenses of the debtor or the debtor’s dependents. Well, does unemployment compensation count as income received by the debtor or paid by another entity in a regular basis for the household expenses of the debtor or the debtor’s dependents? You might think so. Either it is income to the debtor because it does not have to be taxable even, or it is something paid for the support of the debtor or the debtor’s dependents. But there is an exception. The statute goes on to say income does not include benefits received under the Social Security Act.

Now why is that an ambiguity? Because, the Social Security Act, in addition to providing the social security benefits that we usually think of, the survivors’ benefits and the pension benefits that are provided for by the Social Security Administration, also has a program administered by the Department of Labor that provides federal funding to state unemployment compensation programs that comply with the defined federal minimums. So as long as a state program gives unemployment compensation benefits of the defined minimum, the Department of Labor will supplement whatever state funds there
are with a grant from the federal government, and that is provided for under the Social Security Act.

So whether or not unemployment compensations are benefits received under the Social Security Act depends on whether we are talking about direct benefits, which do not exist here - the debtor receives the benefits directly from some state program in every case - or indirect benefits because, indirectly, every state program complies with the federal minimum and provides some benefits that are received by the state under the Social Security Act.

What the Rules Committee was able to do here was to have our cake and eat it, too. The debtor gets to choose whether or not unemployment compensation is counted as income. If they want to count it as income they put the unemployment compensation in the columns that are added up to total to the debtor’s correct monthly income. If not, they can put it in these two boxes on line 9 that are not totaled up to add up to the debtor’s current monthly income. But because it is disclosed, any party and interest can object to the debtor’s non-inclusion of the unemployment compensation and get that issue decided by a court.

Christopher Klein: So the rationale is the form requires the disclosure of information that is pertinent to means test litigation if anybody brings means test litigation.
Eugene Wedoff: Okay, now the third question is similar. When we get to the deduction that a debtor gets for owning an automobile, we are talking, as you heard in the prior panel, about the interpretation of 707(b)(2)(a), that all debts of the bankruptcy code are handled by BAPCPA. And that says for the debtor’s living expenses, the monthly expenses shall be, first, the applicable monthly expense amounts specified under the national and local standards. And that is important.

The national standards of the IRS cover food, clothing, personal effects. The local standards cover housing, automobiles, and transportation of all sorts. And for those local standards for automobiles the IRS has an operating expense allowance, and that could be one, two, or zero cars; you get something even for using public transportation.

So everybody gets an operating expense allowance, and then there is a separate ownership allowance depending on whether you have one or two cars or more. Well, in addition to the applicable expense amounts specified under those local and national standards, the debtors also allowed to deduct actual monthly expenses for the categories that the IRS specifies as other necessary expenses.

So here is the contrast between applicable monthly expense amounts specified under the local standards and actual monthly expenses for these other categories. The Rules Committee, with
the concurrence of the United States Trustee Program, took the first category, the local standards to be an allowance; not the debtor’s actual expenses but an allowance in an amount specified under the local standard. The question is when do you get that allowance for a car? Everybody agrees on the Rules Committee, that as long as the debtor has one dollar of debt owed on the car at the time that the case is filed, the debtor gets the complete ownership allowance.

Similarly, everybody agrees that as long as the debtor has a mortgage of one dollar at the time the case is filed, the debtor gets the complete mortgage allowance allowed under the local standards. But what if the debtor owes nothing? Does the debtor get an ownership allowance or not? It is a debatable point.

And the Rules Committee solved this by telling someone who is filling out a form, “Absolutely nothing.” We just say, “Check the number of vehicles for which you claim an ownership lease expense,” and we give no advise whatever as to how you determine how many vehicles you ought to claim. So the debtor will check what the debtor thinks is appropriate. If the U.S. Trustee notices that the debtor has no debt secured by that automobile, the U.S. Trustee has the opportunity to bring the objection.

Dennis R. Dow: So does any creditor, right?
Eugene Wedoff: Exactly. So here, again, what we were able to do was to be neutral. As you see, the issue has been very well able to be raised in various courts and the court to deciding the question, and hopefully at some point we will have a resolution.

Dennis R. Dow: Well, Gene, since Chris has already confessed earlier, let me ask you and just to test your humility on this one. Is it really neutral, this is not the way the IRS applies the local standards though, is it? You said that the Rules Committee has taken the position for local standards are an allowance. My understanding is that the IRS applies them as caps.

Eugene Wedoff: That is correct.

Dennis R. Dow: And that the taxpayer gets the lesser of the specified or the actual expenses.

Eugene Wedoff: You see I’m drawing a distinction here. On the point that Dennis just raised there, was a decision that had to be made. You could not create a form that told people both to put down your actual expenses and subtract that, or put down the IRS and subtract that without enormous complexity. We made a determination, and again this is with the concurrence of the US Trustee Program, that what the means test was opting for was a mechanical application of an allowed amount for the national and local standards.
Christopher Klein: And created an inquiry notice again. Any creditor or other persons with a dog on a hunt can come in and contest it on a factual basis on a case by case basis.

Eugene Wedoff: And again, that is the importance of this only being a presumption because if someone believed that the debtor was not really needing to spend this much money as they were deducting for their automobile ownership expense allowance, that could go into a 707 (b)(3) totality of circumstances motion. So on that one, yes, Dennis, the Rules Committee did make a choice interpreting the statute. But in terms of whether a debtor could claim the ownership deduction without having actual secured debt on an automobile, as you just saw we took no position on that at all. The debtor claims what the debtor believes as appropriate and parties will be on notice of that and can take whatever position they want on the courts.

Christopher Klein: Well, Section 342(g) of the code provides that if the creditor designates a person or an organizational subdivision to be responsible for receiving notices under title 11 and establishes reasonable procedures, such as notice receivable by creditor or to be delivered to such person, then the notice provided shall not be considered to have been brought to the attention until it gets to the right place.
Okay, well, that is a fairly practical way to bring notice together for a creditor who previously was receiving notice at 50 or 100 different locations and worried about the automatic stay, and there is a free pass for automatic stay violations if the notice is not received. But the question was, well, how do you go about doing this? And the committee’s response to that is rule 2002 (g)(5), which provides that a creditor may treat notices not having been brought to the creditor’s attention under Section 342(g)(1) only if priority interests to that issuance of the notice, the creditor has filed a statement that designates the name and address of the person or organizational division and describes the procedures established that caused them to be delivered to designated persons or subdivision. So it is really an informational requirement.

Okay, if you do this, you got to be prepared to tell the world about it and we need to create a procedure for doing that. Congress could have done that in the statute in 342(g) if it had written it out a little more elaborately. It did not do it and in effect left that to the rule-making process.

Dennis R. Dow: Where does that notice get filed?

Eugene Wedoff: In the court where the case would be filed. But the idea is this: that a creditor would file with the court the name of the person or designated entity within the debtors’ organization that was supposed to get bankruptcy...
notices, and then file with the court the procedures they have in place or sending misdirected notices to that person. That is going to be on file you would hope in the local courts where this creditor does business.

Then if somebody files a bankruptcy case with the wrong address, they put down the lock box; the misdirected notice is not received by the person who should have gotten it, and because of that mistake there is a repossession made after the filing of the case. The creditors are going to be able to point to the materials that are already on file with the court and say, “You blew it.” This is not a violation of the automatic stay for what you are entitled to any monetary penalty.

Christopher Klein: Maybe a stay violation just to remedy the constraint.

Eugene Wedoff: And the important thing from the Rules Committee is that this eliminates what might be a real problem as far as discovery, finding out what the right person was and what the procedures were, whether they were reasonable, but also it gives debtor’s counsel the opportunity of looking to see who the right person is in the first place just by checking the records of the local court.

Dennis R. Dow: You mentioned the way a creditor could use this thing in the flip side. However, apparently is that under
the statute they could defend an action for a punitive sanction of some kind for relief from the automatic stay if they prove that they had designated a person and established procedures. But now, under the rule, if they have not filed this notice they cannot assert that defense, right?

Eugene Wedoff: That is the impact of the rule. This would be in the same way that there are procedural rules that put a limitation period on objecting to exemptions. This creates a procedural requirement for going forward with this kind of defense that you mentioned.

Christopher Klein: And the ultimate question would be whether that is what the Supreme Court has termed a claim processing rule, or whether it is a rule of a different character.

Dennis R. Dow: That was the issue to raise with the question.

Christopher Klein: That is going to have to be sorted out with litigation.

Eugene Wedoff: Well, if someone disagrees with this, and again since this is something that is up for comment now, any comments that people have on this, we invite. Next are reaffirmations that I’ll try to go through very quickly. The problem here is that BAPCPA introduced a new and very complex
requirement for effective reaffirmations layered on the old, already fairly complex requirements for reaffirmation.

Now, even before, under Section 524(c), a debtor’s attorney had to certify that reaffirmation did not impose an undo hardship on the debtor or the debtor’s dependents. We now have a new requirement in a 524(k)(6) which sets up part D of the reaffirmation form that now has to be signed by a debtor in order to have a valid reaffirmation agreement.

And in this new part D, the debtor has to say what the reason is for believing that they can afford to make the reaffirmation payment. They say what their monthly income is, they say what their expenses are, they list what their differences between income and expenses, and then compare that available income to the amount of the reaffirmed debt. And if there is less available income than the amount of the reaffirmed debt, if my income less my monthly expenses does not leave enough to make the payments, then the agreement is presumed to be an undo hardship.

And the debtor can try to rebut that agreement in of that presumption in the reaffirmation form itself by saying why it is that the debtors nevertheless is going to be able to pay the reaffirmed debt. It will be something like my mom is going to give me some extra money, or I’m going to work some overtime, or I’m going to eat less food.
Whatever it is, the debtor can put that there and the judge might accept it. The judge has 60 days with these presumptions in effect to consider whether or not the debtor’s material has rebutted the presumption. If the judge decides it has not, the judge can disapprove the reaffirmation agreement, but only if the judge has a hearing on the reaffirmation agreement on the presumption of undo hardship that is conducted before the discharges is entered.

That is the situation that the Rules Committee had to deal with. Three responses: number one, it would be very easy for a debtor to put down random numbers on part D of the reaffirmation form. Creditor says here, “You want to reaffirm this car; this is going to cost you $400 a month.” Your Schedule I and J does not show that you have $400 a month, so just put down a higher number for your income and a lower number for your expenses so there is at least a $400 difference.

We wanted to avoid that. So rule 4008 which is, in effect, right now is an interim rule, requires the debtor to explain any difference in the “I” income and the “J” expenses between the time the case was filed and the 341 meeting when this reaffirmation was entered into. And that would allow the court to make a determination if there really is an undo hardship that is being covered up.
Secondly, there has to be a filing deadline. If the hearing is going to be held prior to discharge, the reaffirmation agreement has to be filed prior to discharge, and we have a new rule 4008; it is not in effect now but is in the proposed rules for adoption effective in 2008 that would require for the first time that reaffirmation agreements be filed prior to discharge. Discharges cannot be entered into 60 days after the 341 meeting, so this rule requires that reaffirmation agreements be filed before that time.

And then, finally, there has to be a delay of the entry of discharge if there is one of these reaffirmations filed that raises the presumption of undo hardship to give the judge enough time to hold the hearing. At the same time, we want to allow the deadline for filing the reaffirmation agreement to be extended. So if the creditor and the debtor had not been able to reach agreement, we do not have a discharge entered that makes any agreement that they do file “invalid” for being late.

We even want the deadline to be extendable retroactively, and this time we are being careful to say that that extension ought to be freely granted. The idea is if it is a good reaffirmation, if it is a reaffirmation on the debtor’s home, the debtor plainly needs it and can afford it, we do not want that discharge rendered ineffective because the debtor and creditor
Christopher Klein: There is another problem here on the sideline, is that all of these extra things you have to do, delay the entry of the discharge and the Chapter 7 case, well, they are victims of that other than the debtor. And specifically, remember that the automatic stay automatically expires with respect to the debtor’s interest in property the moment the discharge comes down. So, in one sense, all the entire creditor body has an interest if the discharge is going to be issued in getting that thing issued right away. If it is getting held up for various reasons, then you are getting more motions for relief for automatic stay, you have more exposure to stay violations, all sorts of things out there for creditors that they really do not want.

Eugene Wedoff: Okay one last one, Chris. Small business Chapter 11 cases 1020.

Christopher Klein: Small business Chapter 11 cases; under the small business provisions, small businesses now, any operation that has a debt of less than $2 million. It is not like that you volunteered to designate yourself as a small business; you are a small business. And if you are a small business, then under Section 1121 you have a deadline in which to file a plan 300 days in the court under 1129(e) to get a
plan confirmed within 45 days after the plan is filed, unless those deadlines are extended.

And the real problem is it is fine to understand that if you are a small business, but what if you do not know whether you are a small business? The reason I say that is that there is an exception to being a small business if your debt is, say, one million five hundred thousand dollars and that is if there is a creditors' committee. But then there is a provision where you are no longer a small business even if there is a creditors' committee, if the creditors committee has become inactive.

Well, that is a factually intense question; and as we worked through the process, the decision was, first, we would go with a determination that occurs at the time the petition is filed and accept that presumptively, and then require that the debtor specify and that is the specs if they are or not small business, and there is a procedure for litigating the ultimate question, and the debtor is a small business until the court enters a contrary order. And as I noted, the appointment of a committee by the United States Trustee terminates the small business status, and that holds unless and until the court enters a contrary order.

So if you have a case that is filed, looks like a small business, it is a small business. If the US Trustee appoints a
committee, then it is not a small business so you do not have the 300 days and 45 days. And then if the committee becomes inactive and it would become appropriate again to do the small business designation, one needs to go back to the court and actually get an order to it. Again, that was just a processing rule to introduce some order into the potential chaos that was there.

Eugene Wedoff: Well we covered everything we want to cover with. If Dennis will let us, we will certainly be happy to answer questions.

Dennis R. Dow: Are there questions?

Male Voice 1: First of all, thank you very much. I think that was a great explanation of some of the examples and things that need to be considered. I think it is fair to say you presented comments that are going to be more technical in nature, you know, this line needs to be adjusted, or your time frame does not work the way that it probably should. to me. And then there are comments that are going to be more fundamentally targeted on certain aspects that a lot of people may or may not agree with.

Having attended the advisory committee’s debate where they agreed on the interim rules, and having attended the meeting in North Carolina where you considered comments that were filed,
its fair to say that the comments that were technical in nature were given varied consideration.

The response was generally, “Well, we sort of considered that already. We made our decision; we do not want to reopen this and debate and start all over again.” Do you see a different process going forward on the final rules? Essentially, is there a way to have an impact, short of having a member of Congress write a letter, have an impact on something more fundamental?

Christopher Klein: If I understand the question correctly, it is the question that the comments on the rules stand to fall into two general categories. One of them is pretty narrow, specific, technical kind of points, and then the other are larger, global kind of issues. And the question is do we anticipate any change in the way that the committee deals with them in the process?

Eugene Wedoff: Is the committee likely to be open to reconsidering interpretive issues that have already been discussed by the committee?

Christopher Klein: I think the answer to that question is, yes, the committee will be and what was going on, one of the advantages of the three-year process is that we now have the statute in effect and we will have the benefit of what I hope will be the process of decision-making. So where we were
trying to walk down a tight rope not knowing which way the law was going to come out substantively, we will have the benefit of judicial decisions that may point how the law is going to go and, of course, that is in the classic common law tradition that we have.

That is a deliberative process, so there will be decisions on both sides but they will kind of aim a particular way unless the Supreme Court takes certiorari on something; and likewise, the Congress may step in and create a statute that deals with the clarification as well. But it is capable so we will have the benefit of whatever develops along the way and we should be smarter than we are now.

Eugene Wedoff: I think Chris has given a specific example of what I think would be necessary for the Rules Committee to reconsider one of these policy decisions, and that is essentially if there will be something new made in the argument for coming out differently; that something new could be a change in the decision of law, it could be a change in the statute itself, it could be a new argument, a new problem that has come up that was not addressed to the committee before.

I do not think it is likely the committee would take the same arguments that had been raised before and already considered, and spend time rearguing those points. But there
is certainly is the possibility for new matter being brought that would cause the committee to reconsider.

Christopher Klein: And also do not lose sight of the Supreme Court here. It is not just the Supreme Court granting certiorari on issues specific to the 2005 amendments; that is going to take awhile for that to filter through the process. But the Supreme Court has been granting certiorari in two, three, four bankruptcy cases a year and they have a way of telling us a lot about interpretive aspects of the code, and it could be that there is a Supreme Court decision along the way that is one of those kind of developments.

Dennis R. Dow: Any other questions for this panel?

Christopher Klein: Judge Teel had one.

Judge Teel: When we send in comments, do you prefer them to be a separate letter to each rule, or is it okay just to do these in the same letter?

Christopher Klein: The question is whether the comments should be lumped together or separate comment on each rule. I think as long as they are clearly stated in separate paragraphs with separate headings, it is fine to put them all into one letter, or you can put a cover letter on and have a separate exhibit or attachment for each rule you commenting in. I think it is a relative and contextual in terms of the comments.
Eugene Wedoff: A reporter will break out individual comments from a larger one and put them in the proper place in our agenda book so that we can consider them in conjunction with each rule that we look at.

Christopher Klein: He would be grateful if you did it for him, or at least started it.

Dennis R. Dow: All right, well, we reached the end of the day. I think it is fair to say that there are strong views held with respect to the need for an impact of this legislation and the way that it is being interpreted and applied. Some things are clear; many are not.

Some trends are emerging. We know that filings are down and the composition of filings have changed, but recent information indicates that they are trending back up and the long term effect is probably unclear. Empirical studies will probably have to be done in the future to determine whether the law is effective in screening out abusive cases, whether it has provided barriers to relief for needy debtors, whether it has enhanced recoveries for creditors, and whether credit counseling the requirement is efficacious and available to debtors.

The court says - is probably was predictable - has struggled with certain provisions of the law, and looking at the same words and the same legislative history and applying
the same principles, have reached different conclusions on key issues, and appellate courts are probably going to have to weigh in for us to know the answers to some of these questions. As we have discussed, we got new rules and forms that will help to shape the process on which you can provide input and we urge you to monitor those and comment on that.

I think the one thing that we can all agree on is that we want this process to work. We want the bankruptcy system to work and it has been remarkably flexible and viable over the years. Our goal at ABI, in sponsoring this conference, was to facilitate an intelligent and civil discussion of this process. And we hope that we have done that today. See the website for additional material that may be posted with respect to the conference and supplements what we did today.

And I thank all of you for attending.

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