

# [Regional impact of the new bankruptcy law](https://assignbuster.com/regional-impact-of-the-new-bankruptcy-law/)

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Introduction.

The law can generally be defined as a body or system of rules or statutes that are meant to serve given objectives such as protecting individuals under its umbrella - and in its nature - to serve for the best interest of the society. According to one of the doctrines of equity, law looks at the intentional and not the form meaning that in reviewing, formulating and application of any set of rules or statute, the parties should focus on the purpose or the intention.

One of the laws that was widely abused in this regard is bankruptcy law and in particular chapter 7 which covers liquidation. Bankruptcy law in generality was formulated to protect persons who cannot pay up their debt due to insolvency thus the intention of the law is that it should be used as a last resort (Nolo. com, 2008 & Kass, 2005).

According to statistics, the old bankruptcy law in its nature defeated this maxim (mentioned above) in the sense that most individuals and businesses preferred to use the liquidation act (cap 7) over repayment statute (cap 13) even when they had the ability to pay the debts thus defeating or abusing the purpose of bankruptcy law as a measure of the last resort that is meant to protect a person against over burdening debt in case of bankruptcy.

According to library of congress (n. d.) report, in 1998 bankruptcy fillings exceeded 1 million being the highest in American history and this figure was gradually increasing over the years to around 1. 6 million in 2004. Therefore there was need for reform to reverse this trend since the law had in its nature become obsolete to the extent that its form-and in particular its leniency - did not adequately serve the purpose introducing a legal loophole that could be used by devious and shrewd parties to get away with debt unjustifiably (Library of congress, n. d. & Kass, 2005).

Problem statement.

This paper is an evaluation of the old bankruptcy law in relation to its leniency and its failures to serve its purpose in an attempt to justify the reforms. In addition, the paper will also look at the new bankruptcy law, the new reforms and the impact to the business community in an attempt to evaluate the new bankruptcy law’s effectiveness and applicability.

The bankruptcy law.

Bankruptcy, normally referred to as reorganization or liquidation, is a federal court process that allows a debtor either a person or business to eliminate their debt or repay them under the umbrella and protection of the bankruptcy court. There are two main provisions that are covered with the bankruptcy court namely chapter 7 (which provides for the process of liquidation) where property is disposed off to pay of as much liability as possible while providing enough resources for a fresh start and chapter 13 (which provides for reorganization or repayment) where the debtor is protected by the court to repay for debt is a period of three to five years depending on his ability. (Findlaw, n d.)

Bankruptcy law was adopted from the English law in 1800, it provides framework that will help debtors to be relieved of their debts either through unconditional discharge or conditional discharge of debt. The concept was explained in 1898 (but later repealed in 1978). According to congress, “[W]hen an honest man is hopelessly down financially, nothing is gained for the public by keeping him down, but, on the contrary, the public good will be promoted by having his assets distributed ratably as far as they will go among his creditors and letting him start anew.” (Liberty of Congress, 2005).

However, over the years the public raised concerns with bankers and lawyers fundamentally differing on the issue. The main concern being the fact that a debtor who could easily pay their debt might easily resort to liquidation act due to its leniency. Thus, most of the businessmen and individual with debt could easily get away with their debts and have a new start despite the intention of the law which is to offer relief or a second chance to overburdened individual and businesses (Skeel, 2001).

The following are the basic provisions of the statute which show extent of leniency the old bankruptcy act.

Firstly, Chapter 7 bankruptcy cancels all your debts but the court takes the right and control over your assets and sells some of your property to pay off some of your debt while the rest is unconditionally discharged. In should be noted that this statute is only applicable to individual or businesses but not to corporations.

The process of filling of bankruptcy is relatively cheaper in that it costs approximately $247 and an individual filing for bankruptcy only requires filing of relevant documents with the court which commonly takes only one trip to the courthouse. Restriction of filling for bankruptcy under section seven are; if your eligible to file for bankruptcy under chapter thirteen which handles reorganization or conditional discharge of liability, or if one has received a bankruptcy discharge within the last six to eight months among other restrictions

(Lawyers. com, 2008 & Haman, 2005).

Secondly, filing of bankruptcy automatically effects an “ order of relief” or automatic stay which automatically prevents the creditors from collecting or repossessing an individual he/she owes them temporarily unless the creditor shows the court that the property a reasonable cause that mandates him/her to go ahead and claim his payment or repossess the debtor for instance if the nature of the goods are such that they could considerably deteriorate in value given the lengthy period of bankruptcy. (Elias, 2007 & Haman, 2005).

Thirdly, chapter seven places the financial affairs of a debtor into the courts hands, the property and debts are from the moment the suit is filed handled by the court therefore a debtor cannot sell or give away his property or pay off debts without the consent of the court but the income and property acquired after filling of bankruptcy belong to and can be handled by the debtor in any way he/she so wishes.

The court handles the debtor’s property using its appointed trustee whose duties is to sell and sell the property owned by the debtor and see that the creditors are paid as much as possible from the proceeds realized. The trustee’s term of payment are related to the amount or extent to which he/she serves the interest of the creditor i. e. the more he/she collects and pays creditors the more he/she gets paid thus creating a mechanism that will benefit the creditors (Lawyers. com 2008 & Findlaw. com, 2006).

Under chapter 7, a debtor’s property is divided into two those that can be disposed referred to as nonexempt goods and those considered personal will materially affect the welfare of the debtor if disposed thus exempted from sale to repay the creditor. Exempt goods vary from state to state with others being more lenient than others but generally personal effects, reasonable and necessary household goods and appliances, unpaid but earned wages, tools of trade, part of equity on motor vehicle, life insurance among other properties that are reasonable in light of an individual’s welfare ( Elias, 2007, Lawyers. com 2008 & Findlaw. com, 2006).

The bankruptcy process usually took the following steps; the debtor is required to file a petition giving relevant information in relation to his income expenses the debt owed among others. After filing such petition, the courts analyze if the candidate qualifies for bankruptcy under chapter 7 or can reorganize his debt under chapter 13 and if he/she qualifies for chapter 7 a court-appointed trustee takes over the debtor’s assets and debts. The next step is to twenty to forty days the trustee convenes a meeting - which is legally referred to as 341 hearing - with the creditors with the debtor is supposed to be present and answer questions that the trustee poses to him/her under oath, creditors are at liberty to ask questions or seek clarification. (Elias, Renauer & Leonard, 2007).

A creditor has the option to present to court reasons why he/she should be allowed to collect his/her debt within 60 days from the meeting or the property in question will be taking by the trustee and sold together with other assets. Secured debts were however, treated differently in that if one was late on his payment at the time of filling bankruptcy; the creditor can have the automatic stay lifted and repossess the goods or foreclosure the house or other property but if one was one time he/she will be expected to continue payment as before (Lawyers. com 2008 & Findlaw. com, 2006).

Reasons Justifying reforms.

Firstly, under the old bankruptcy law it was relatively easy for anyone to file for bankruptcy since it translated to giving a person the option of filing either under chap 7 or chapter 13 and in addition, it only required one trip to the courthouse and an individual is declared bankrupt thus protecting him/her from paying his credit. Moreover, a debtor could file for is that if a debtor is facing repossession or foreclosure in a few days, it is possible to file a petition and other requirements and avoid such actions, though this law is understandable and necessary it is possible or gives a chance for people who are facing emergency repossession due to their negligence to take advantage of it unless especially under the lenient old bankruptcy law.

These elements clearly introduce a room for abuse of the act in the sense that most of the irresponsible and negligent people could easily get away with the debt. For instance, according to a survey by earnest and young, 25% of the debtors who filed for bankruptcy under chapter seven could easily pay over 30% of their non housing debt over a five year period (Library of congress, n. d., Martin & Paley, 2006 & Nolo. com).

Secondly, under the old bankruptcy law, it was possible to move to another state and file a bankruptcy suit in that state under the period of two years therefore this could also be subject to abuse in the sense that one can move to a state that proves generous or considerate in terms of exempt goods this acts are referred to as the mansion loopholes.

Therefore, it was possible for an individual to prior to bankruptcy assess and move to another state which has statutes declaring many of his/her property exempt in an attempt to get away with most of the debt. This term deficiency which is referred to as ‘ mansion loophole’ was also a concern in that though the act was introduce to protect an honest indebted person such moves amount to malice or taking advantage of the statute at the expense of honest creditors (Nolo. com, 2008 & Library of congress, n. d.).

Thirdly, a report to the house committee revealed that the law in the old state encouraged misconduct among lawyers and debtors, for instance, reports showed that prior to filing bankruptcy; some consumers renewed their credit cards and accumulated debt with the intention of maliciously avoiding payment under the umbrella of the bankruptcy act (Martin & Paley, 2006). This revelation is compounded by the fact that increase in bankruptcy has led to loss ofmoneyby creditors, according to economic report, in 1997 alone debt discharged under chapter 7 totaled $ 44 billion dollar and in most cases most of the property turns out to be exempt and creditors end up loosing all their debts which are translated to expenses ( Library of congress, n. d.).

One witness in the house committee remarked that, “ Like all other business expenses, when creditors are unable to collect debts because of bankruptcy, some of those losses are inevitably passed on to responsible Americans who live up to their financial obligations. Every phone bill, electric bill, mortgage, furniture purchase, medical bill, and car loan contains an implicit bankruptcy `tax' that the rest of us pay to subsidize those who do not pay their bills. Exactly how much of these bankruptcy losses is passed on from lenders to consumer borrowers is unclear, but economics tells us that at least some of it is. We all pay for bankruptcy abuse in higher down payments, higher interest rates, and higher costs for goods and services.” Library of congress (n. d.).

The new bankruptcy reforms.

Thisobservationled to the 2005 which introduced the “ Bankruptcy abuse prevention and consumer protection act of 2005” that introduced fundamental reforms specifically countering the leniency of bankruptcy laws, among the major reforms include the following, Firstly, as mentioned under the old rule, applicants could choose between chapter 7 and 13 but in the new reforms debtors with high income are restricted to apply for bankruptcy under chapter 7. The general rule introduced restricts filling of bankruptcy under chapter 7, if your income is less than or equal to the median income, one is eligible for liquidation but otherwise he/she will have to file under reorganization act or, an applicant is required to go through a ‘ mean test’ to determine if he/she is eligible to file for bankruptcy under chapter 7.

The mean test is carried out to determine if the applicant has enough disposable income to pay of the debt, specified allowances are deducted from your monthly income and if the net exceeds a certain amount one cannot be allowed to liquidate his/her asset under chapter 7. In addition, it is mandatory under the new law for the debtor to complete financial management and budgeting counseling from a court approved agency before the petition goes through for both chapter 7 and chapter 13 under sec. 256 of the bankruptcy and reform act. (Findlaw. com 2006 ; Nolo. com, 2008).

Secondly, even after the petition is granted certain stringent rules have been introduced for instance, to avoid misconduct and fraudulent behavior lawyers have to personally vouch for their clients and can be held personally liable for such actions. Section 256 of the bankruptcy abuse and prevention act 2005 limits the debtor’s ability to file successive case of bankruptcy and specifies that for a debtor to file a suit of bankruptcy in a given state he/she must be a resident of that state for not less that two years to claim for homestead exemption and for other assets the time frame differs depending with the type of asset. Moreover, the act also provides for debtors who knowingly load their credit cards and obtain cash advances before filing for bankruptcy. (Library of congress, n. d. ; Elias, 2007).

Thirdly, certain restrictions have been introduced with regards to exempt goods and non exempt property even though this still differ from state to state, in addition another twist that has been introduced that makes it more stringent to apply for bankruptcy is calculation for personal expenses. Under the old rule, persons applying for bankruptcy reorganization (chapter 13) had to declare and devote all their disposable income after deducting actual expenses for the purposes of servicing their debt. In the new rule the expenses are determines by IRS and not based on the actual expenses, this expenses are not deducted from the monthly income but from the average income the debtor earned for the last six months prior to filing bankruptcy (Nolo. com 2008 ; Findlaw. com 2006).

Fourthly, some welcomed provisions were also introduced e. g. bankruptcy information to the public under the old bankruptcy law information about a filer was readily available to the public but under the new law, the bankruptcy judge can restrict access to certain information for example the minors or immediatefamilyof the debtor. This is to ensure that the innocent parties are protected from the embarrassment and resultingstressthat might arise from the ordeal.

Furthermore the law adopted certain provision from the bankruptcy review commission that seek to protect small business owner and single asset real estate owners for example sec. 256 makes changes to the automatic stay provision for single real estate owners to allow them to collect rent and/or other proceed and make interest rates payment on the estate. (Library of congress, n. d. ; Martin ; Paley 2006)

Impact of new bankruptcy law.

Firstly, the new bankruptcy law introduced cumbersome and lengthy process due to the complicated procedures that one has to go through when filing for bankruptcy. This has led to an increase in attorney fee due to the time consuming process that they have to go through during the process and also commits the lawyer in that he might be personally thus liable in the event of fraudulent and misconduct during the process.

According to statistics carried out in Houston, fewer people apply for bankruptcy due to this stringent rule and even more opt for reorganization rather that liquidation which was has in the recent passed be subject of abuse, aninterviewwith a federal court (2007) judge revealed that the fillings have tremendously reduced and she also expressed her satisfaction since they (as part of the bankruptcy committee) achieved what they targeted and that is to reduce the ease of debtors avoiding their legalresponsibility( Nolo. com 2008 ; Kass, 2005).

However, due to the strict rules introduced, it will be difficult for debtors to be absolved the burden thus the law can be counterproductive to the extent that honest middle income and low income earners will find it difficult to file the suits successfully. According to Jeff Morris of American bankruptcy institute in Alexandria, fewer people will be able to avoid their debt obligation under the new rule but he also noted that this will effect will be short term given that most people who file bankruptcy petition are economically challenged and thus have no option but to file thus in the long run it might not successfully serve the purpose, quoting his remarks,“ the thing that makes people file for bankruptcy is not the statute, its lack of money, and that happens whether the bankruptcy code says X or Y," he says. " If you can't buyfood, you don't worry about the niceties of the statute.” (Axtman, 2005)

This means that one adverse impact of the law is that it will make the poor more poorer since it will be more difficult for them to hire an attorney since bankruptcy fee have tremendously increase and the tedious time consuming process might lead to increased suffering. For instance, the new strict rules will fundamentally affect the welfare of bankrupt debtors since it does not base its calculation on actual costs as deductible from the disposable income.

Experts argue that due to bankruptcy laws individuals will result to informal means of solving their problems or informal bankruptcy where people simply relocate, change their contacts and address and apply illegal means to hide their assets and/or restructure their financial affairs. (Axtman, 2005 ; Kass, 2005)

Another impact introduced by the new laws is that due to the processes and procedural statutes introduced, the courts are under tremendous pressure both financially and otherwise in dealing with the cases. According to Judge, Barbara Lynn interview, the act created more than 35 types of motions objections and hearings thus putting the justice system under pressure, in addition clerical costs in the department of justice bankruptcy office have tremendously increased due to the introduction of the new bankruptcy law in the country. (US courts 2007).

According to federal court reports in 2005 bankruptcy suits increased tremendously as people tried to file the motion before the new law came it into force. The new law which was signed into law in April 2005 came into force in October 2005. According to the department they needed an additional 600 000 clerks to handle the petition and at the time predicted that clerical costs would increase in the long term by approximately 10% due to the provisions of the new law (US courts, n. d.).

Conclusion.

In conclusion, the new laws introduced are effective due to the following reasons, firstly, bankruptcy suit especially chapter seven in my opinion should applied as a humanitarian law i. e. to give the debtor a second chance, given the recent past abuse of the law and its provisions, it was necessary to make them more stringent in order to avoid and mitigate chances of it being abused at the expense of hardworking American citizens as they bear the cost of irresponsible debtors.

While this paper recognizes the plight of the poor and the economic hardship that can drive anyone to bankruptcy, the law reforms certainly provide for the poor and the genuinely handicapped (economically) due to the following facts. Firstly, the mean test applied used real and practical median values to calculate the eligibility therefore for a poor person; it is obvious that given his/her income, one could easily qualify for liquidation in addition, the mean test introduces a practical and fair way of determining the consumers financial position compared to the silent old bankruptcy law which created an avenue for deceit.

Secondly, the IRS based calculations are based on practical and average household expenditure which the poor or low income earners can easily qualify but the rich people who would like to get away with debt wont. Therefore, it is my opinion that though necessary procedural reforms have made it difficult to file for bankruptcy, the reforms do not affect the poor but are meant to make the rich pay for their dues.

Thirdly, the introduction of counseling and financial management session will help people who are poor financial manager acquire skills necessary for better management in future and this should be the spirit of second chance. Therefore though, it is important to have a bankruptcy law it is not something to be proud of therefore the cries of the law being mean and an act of oppressing the poor is not quite true, in my opinion the poor can easily pass the mean test and other procedural reforms introduce. The real message is that debt Americans should spend within their means and the bankruptcy option is only helpful to honest citizens who need and deserve a fresh start.

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