THE NEW BANKRUPTCY LAW:
INTENDED AND UNINTENDED CONSEQUENCES

In 2005, Congress completely overhauled the Federal Bankruptcy statute. One of the stated central purposes of this overhaul was to prevent abusive filings, i.e., to prevent those who otherwise had the ability to repay their debt from filing a bankruptcy to enable them to discharge said debt.

Now, some five (5) years later, and after experiencing a momentous economic decline that has shattered home values, stock market portfolios and stable employment histories, we are able to evaluate the success or the failure to date of the statute.

SHOCKING FACTS

In an article appearing in the periodical Residential Real Estate Today on July 28, 2011, the following statement was made:

> More than 50% of American homeowners are bogged down by underwater mortgages.

(other reports indicate a smaller but still staggering percentage 33⅓% have no equity - Business Wire 10/5/11. Half of borrowers will be underwater - Huffington Post 10/7/11)

In August 2011, Yahoo.com reported:

> "In metropolitan Phoenix two-thirds of all residential mortgages are underwater and median home prices are down 53% since the bubble peaked in 2006."

On November 24, 2009 Residential Real Estate Today reported:

> "Forty-six percent of residential real property in Tampa Bay, Florida is underwater."

(with similar "percentages" for the state of Florida generally)

On April 16, 2010, the New York Time reported that in the New York City area, as to those mortgages that were underwater, the average short fall was 39%, and that said owners were not likely to see equity until 2017 or later.

On August 23, 2011 Yahoo News reported:

> "There are now almost 46,000,000 people in the United States on food stamps, roughly 15% of the population. That's an increase of 74% since 2007, just before the financial crisis and a deep recession led to mass job losses."

THE MEANS TEST

The keystone to the Bankruptcy statute, as it was amended in 2005 is the "Means Test".

Stated simply, the Means Test is an artificial formula that must be calculated, not using a Debtors' actual expenses, but rather certain limited authorized expenses to see whether they should be prevented from going into bankruptcy because they SHOULD have sufficient income to make some repayment to their creditors.

This Means Test represents a change from prior bankruptcy law, which based the availability of bankruptcy relief on the Debtor's ACTUAL income and expenses to determine whether they in fact had any available surplus to pay to their creditors. If, based upon their actual expenses, they did not have available surplus, then they would be eligible to file for bankruptcy.

Although many of the authorized Means Test deductions are purely arbitrary in that they are based upon standards imposed by the government without regard to an individual's personal situation, certain of the deductions remain tied to the debtor's actual expenses. Notably, these include:

a. mortgage expenses without limitation;

b. car payments without limitations;

c. actual income taxes paid; and

d. payments for health insurance, life insurance, disability insurance, and health savings plans.

In light of the fact that the forgoing actual expenses are authorized deductions for purposes of satisfying the Means Test, a glaring injustice was created whereas low income debtors, and debtors with no car payments and no home mortgage expense were quite limited in the deductions

available to them. Those higher income debtors who had substantial mortgages, major car payment, and were able to provide for themselves with health insurance, disability insurance, life insurance and health savings plans were granted vastly more favorable treatment.

Thus we have a fundamental anomaly under the new Bankruptcy Law. Bankruptcy treats substantially more favorably those people who at least in the abstract require less protection. Conversely, those people who really need the benefit of the bankruptcy law, other than the very poor, may very well be precluded from the benefits it provides.

THE NEW YORK EXEMPTION SCHEME

The basic principle of bankruptcy law is to create a process whereunder a debtor may discharge (walk away from) dischargeable debts. As a quid pro quo however, the individual must deliver non exempt assets to the trustee in bankruptcy to be distributed for the benefit of creditors. Thus, of significant concern to a potential debtor in bankruptcy is: what assets may he keep, and what assets are required to be given to a trustee to be distributed for the benefit of creditors?

Typically, the asset about which a debtor is most concerned is his home. Is he able to keep his home, even though he is seeking to discharge his debts in bankruptcy? Under bankruptcy law, each state is entitled to create its own set of exemptions. New York State has done so, creating its own "homestead exemption," which until recently lagged behind that available in a great number of other states. On June 4, 2009, however, New York State revamped its exemption statute to provide that each owner of a home could exempt the first $150,000 of equity therein. Thus, husbands and wives, as co-owners of their home could exempt a total of $300,000. It is both troubling and ironic that the statute was implemented in 2009, at a point in time where a vast percentage of homes in New York State were, and still remain "underwater". Stated differently, the exemption that was finally created to protect a meaningful amount of equity in a home, ended up doing very little for most debtors because through a combination of declining property values and historical and often successive refinancing of home mortgages, the debtors had little if any equity in their property. This potential $300,000 homestead exemption did nothing to benefit the greatest portion of those people requiring bankruptcy assistance.

Once again, the statute benefitted only that small percentage of "richer" persons seeking bankruptcy protection.

CONCLUSION

The foregoing discussion is not meant to downplay the benefits that a bankruptcy can provide to those more affluent debtors, such as business owners, professionals and the like, who suffer from a variety of serious financial problems, whether it be business downturn , long term unemployment, or serious or catastrophic illness, who still possess assets of value, substantial mortgage obligations, and some level of income, although perhaps substantially reduced. There is a real place and benefit for the bankruptcy laws in aiding these people who have suffered situational reverses. Additionally, it is still available to a great number of people in need of rehabilitation. However, a distressing implication of the 2005 amendments, is that they do make it difficult, although not impossible, for a segment of society otherwise in need, to obtain bankruptcy relief.

The point, however, is that while bankruptcy relief to these deserving people continues to be available, and for that matter, bankruptcy relief to the very indigent continues to be available, the unintended consequence of the "new bankruptcy laws" is that with respect to that vast middle ground of middle class debtors, i.e., those who are struggling with a low to moderate salary, with a modest home, with a small mortgage, with cars that have been totally paid up and although aged continue to run, these people may find themselves lost in the shuffle. It is unfortunate that for these people, under the new laws bankruptcy may be unavailable as an option.