Dennis LeVine & Associates

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2005 BANKRUPTCY REFORM – A SUMMARY OF CHANGES AFFECTING SECURED CREDITORS IN CONSUMER CASES

The recent amendments to the Bankruptcy Code, signed by the President on April 20, 2005 ("New Law") made a number of significant changes in the Bankruptcy Code. This article highlights provisions of the New Law effecting secured creditors.

CHANGES AFFECTING ALL CASES

1. Effective Date

The amendments under the New Law generally are effective for cases filed on or after **Monday, October 17, 2005** (i.e. 180 days after the date of enactment). Certain changes, including limitations on homestead exemptions, became effective on April 20, 2005.

2. Extended time between discharges

A debtor who received a Chapter 7 or 11 discharge in a prior case now must wait eight (8) years (rather than 6) before he can file another case and obtain a Chapter 7 discharge. Where a Chapter 13 debtor previously received a discharge in Chapter 7, 11 or 12 case during the 4-years prior to filing the pending case [or received a discharge in a Chapter 13 case during the 2-year period prior to the filing of the pending case], a debtor will not receive a Chapter 13 discharge.

3. Automatic Stay

A. Serial Filings

The automatic stay for a debtor who files a Chapter 7, 11 or 13 within one year of the dismissal of an earlier case will be limited. The stay in the second case will terminate **automatically** 30 days after the filing. This provision does not apply to a Chapter 11 or 13 case filed after a dismissal order under §707(b).

Where there is a third repeat filing (i.e. the second filing within one year of the dismissal of an earlier case), the automatic stay will not go into effect at all. At the request of any party the Court must promptly enter an order confirming the inapplicability of the stay.

EXCEPTION: The stay may be continued as to one or more creditors where the debtor or trustee files a motion, and demonstrates that the second case was filed in good faith with respect to the creditor sought to be stayed. As to a third bankruptcy filing within one year, the debtor or a trustee may file a motion to impose the automatic stay, but must demonstrate that the third filing is in good faith with respect to the creditor sought to be stayed. The extension or imposition of the stay in such cases will be very difficult to obtain under the New Law, since there is a presumption of bad faith that can be rebutted only by clear and convincing evidence.

B. In Rem Relief

When the stay is lifted in cases involving multiple filings, the New Law now specifically authorizes Courts to grant "in rem" relief to preclude any other related party from filing bankruptcy in an attempt to stop a foreclosure sale in cases involving subsequent transfers of real property without the consent of the secured creditor or court approval.

C. Notice Required to Specific Creditor Address

Debtors have been notorious for

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sending bankruptcy notices to a creditor's payment address or some other unrelated address. Under the New Law, no monetary penalty may be imposed on a creditor for violating the automatic stay or for failing to turn over property unless notice of the bankruptcy filing is served to an address the creditor designated with the Court, or served at the address contained in two communications from the creditor to the debtor sent within 90 days of the bankruptcy case (the notice also must include the account number used in the two communications). An ineffective notice will subject the creditor to liability for violating the stay only if notice of the bankruptcy was "brought to the attention of the creditor" (defined as receipt by a person designated by the creditor to receive bankruptcy notices).

5. Added Preference Protection; Extending Time to Perfect Title Lien

Under existing law, a title lien must be perfected under state law within 20 days of the customer obtaining possession. In the event the title lien is not timely perfected during the 90 day period prior to bankruptcy, the lien can be avoided by the debtor or trustee. Under the New Law, the time period for lien perfection has been extended to 30 days.

CHANGES AFFECTING CASES UNDER CHAPTER 7

1. The new §707(b) means test

The centerpiece of the New Law is the means test. Under the New Law an individual Chapter 7 debtor with primarily consumer debts may have his case dismissed for abuse (or, with the debtor's consent, converted to Chapter 13). The prior standard of "substantial abuse" has been eliminated. The New Law contains a long and complex formula for calculating the means test. Abuse can be found in one of two ways: (1) through an unrebutted presumption of abuse arising under the new means test, or (2) on general grounds, including bad faith, determined under the totality of the circumstances. The means test presumption is completely inapplicable to debtors whose income is below the state median income.

When the debtor's income exceeds the defined state median income, any creditor or party in interest (as well as the Court on its own initiative), may file a motion seeking dismissal for abuse. When the debtor's income **does not** exceed the defined state median, however, only the Judge or U.S. Trustee may move to dismiss the case.

2. Dismissal for Failure to File a Statement of Intention

Under Section 521, individual debtors are required to file a Statement of Intention with regard to secured claims. There now will be an effective consequence for debtors who fail to do so. Under the New Law, a debtor who fails to timely file this information within 45 days after filing the petition will have his case automatically dismissed on the 46th day. Upon a creditor's request, the Court must enter an order to that effect within five days.

EXCEPTION: The debtor or the trustee may file a motion within the original 45-day period requesting the automatic dismissal under this provision be delayed for up to 45 additional days. The motion must show that the debtor attempted in good faith to file the required information, and administration of the estate by the trustee would be in the best interest of creditors.

3. Ride-through Eliminated

The New Law specifically precludes a Chapter 7 debtor from retaining collateral without redeeming or reaffirming the debt (i.e. the debtor can no longer simply "retain and pay"). The New Law requires the debtor to perform this intention (i.e. redeem or reaffirm) within 30 days after the first date set for the meeting of creditors, unless the Court extends the period for cause during this 30-day period. Further, a Chapter 7 debtor must surrender any personal property subject to a purchase money security interest unless the debtor, "not later than 45 days after the first meeting of creditors," redeems the property, or enters into a reaffirmation agreement.

Section 362(b) has been amended to provide that the stay automatically terminates with respect to, and removes from the estate, personal property that is collateral for any secured claim (not just property subject to purchase money security interests) or subject to an unexpired lease where the debtor fails either to file the required Statement of Intention within 30 days of the case filing, or fails "to take timely the action specified in such statement . . . unless such statement specifies the debtor's intention to reaffirm such debt on the original contract terms and the creditor refused to agree to the reaffirmation on such terms."

4. Reaffirmation

Reaffirmation forms will have to be significantly changed. Under new §524(k), a debtor must receive an extensive set of disclosures as an additional condition for a reaffirmation agreement to be legally effective. The reaffirmation agreement also must disclose the debtor's income, the debtor's actual current monthly expenses, and the resulting balance available to pay the debt proposed to be reaffirmed (the so-called new "§524(k)(6) statement"). When the debtor appears to have insufficient income to make payments set out in the proposed reaffirmation agreement, a presumption will arise that the reaffirmation agreement is an undue hardship on the debtor.

5. Redemption

Under the New Law, the value of personal property redeemed under Section 722 will be replacement cost (i.e. the cost to the debtor of replacing

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the property – without deduction for costs of sale or marketing). For property acquired for personal, family or household purposes, replacement cost is the retail price for property of similar age and condition. The prior cases finding redemption value to be wholesale value (i.e. what the creditor would receive after repossession and sale) have essentially been overruled.

CHANGES AFFECTING CASES UNDER CHAPTER 13

1. Plan length

For debtors whose income is equal to or greater than the applicable state median income, the Chapter 13 plan must last for five (5) years (unless the plan provides for full payment of all claims in less than five years).

2. Confirmation hearings

Waiting 8 to 10 months for a confirmation hearing should become a thing of the past. The New Law requires the confirmation hearing take place between 20 and 45 days after the Creditors Meeting, unless the Court determines that it would be in the best interest of creditors and the estate to hold an earlier confirmation hearing and there is no objection.

3. Eliminating "Cramdown" for Certain Secured Loans

The debtor's ability to strip down secured claims to the value of the collateral in Chapter 13 cases, commonly referred to as a "cramdown", is significantly limited. Under the New Law, a cramdown will not be allowed for (1) purchase money security interests in cars acquired for personal or family purposes and financed within **910 days** of the bankruptcy filing (two days less than 2-1/2 years) or (2) as to all other secured debts (whether or not involving purchase money security interests), incurred within one year of filing bankruptcy.

4. Valuation of Secured Claims/Lien Retention

For collateral which remains subject to cramdown, the stripped down value of a secured claim must be based on the cost to the debtor of replacing the collateral – without deduction for costs of sale or marketing. In the event the collateral was acquired for personal, family or household purposes (e.g. a car), replacement cost is defined as the retail price for property of similar age and condition.

A Chapter 13 debtor can no longer provide for the early release of a lien upon payment through the plan of a stripped-down secured claim. The secured creditor retains its lien until the full amount of the claim is paid or the plan is completed.

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2005 AUTO FINANCE STUDY SHOWS STRONG CREDIT QUALITY TRENDS

Automobile loan terms continue to stretch to help make monthly payments affordable, according to Consumer Bankers Association's 2005 Automobile Finance Study. Loan maturities on new vehicles more than 60 months now represent more than double the percentage reported in the 2000 report (45% at year-end 2004 versus 40% in 2003 and 21% in 2000). 88% of new car loans are now longer than 48 months, up from 85% a year earlier. Survey respondents, including banks and captive finance companies, reported policies that allow average maximum maturities of 77 months up from 73 months a year earlier.

The average new vehicle loan size decreased by 2% to $22,638 from $23,076 a year earlier, the first decline in recent history. The average used vehicle loan size decreased by 3% to $15,561, from $16,521 a year earlier. Auto lease terms greater than 48 months represented 6% of new vehicle originations, compared to 14% a year earlier. On average, 22% of leases did not reach full-term, half the percent reported a year earlier.

BANKRUPTCY PETITIONS IN MAY UP ONLY 5 PERCENT OVER 1 YEAR AGO

Personal bankruptcy filings in May rose nearly 5 percent over year-ago levels, but fell sharply from the surge experienced in April when filings soared nearly 17 percent year-over-year, according to cardweb.com. Nearly 143,000 filings were made during May, compared to 136,509 for May 2004. Bankruptcy filings declined about 4 percent for the full-year of 2004.

Dennis J. LeVine is Board Certified in both business and consumer bankruptcy law by the American Board of Certification. Mr. LeVine was admitted to the Florida Bar in 1983, and practices in the federal courts of all three Florida districts. He has concentrated his practice in bankruptcy and collection law for 21 years.

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The Timeless Wisdom of Yogi Berra

- Pair Up in Threes.
- The Future Ain't What It Used to Be.
- It's Déjà vu All Over Again.
- It's So Crowded, Nobody Goes There.
- You Saw Dr. Zhivago? Why? Aren't You Feeling Well?

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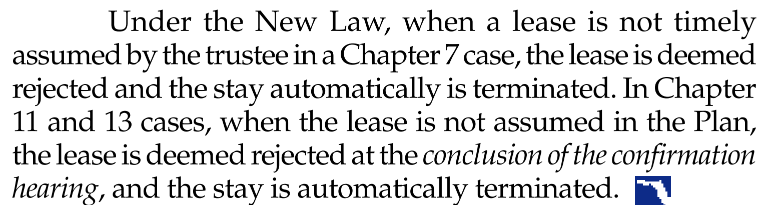
5. Adequate Protection/Payments Before and After Confirmation

The New Law contains two significant changes attempting to require debtors to make adequate protection payments on secured claims in Chapter 13. First, unless otherwise ordered by the Court, the debtor must make monthly pre-confirmation adequate protection payments directly to a secured creditor or personal property lessor and provide the trustee with proof he made these adequate protection payments. This amount is deducted from the preconfirmation plan payments made to the Chapter 13 trustee. The amount to be paid for preconfirmation adequate protection is not clearly defined (i.e. the amount called for by the plan, or the monthly contract payment).

Second, the Chapter 13 plan must provide for payment of secured claims in equal installments "sufficient to provide adequate protection".

6. Personal Property Leases

Under the New Law, when a lease is not timely assumed by the trustee in a Chapter 7 case, the lease is deemed rejected and the stay automatically is terminated. In Chapter 11 and 13 cases, when the lease is not assumed in the Plan, the lease is deemed rejected at the *conclusion of the confirmation hearing*, and the stay is automatically terminated.



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