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# New bankruptcy law produces unforeseen results, experts say

By Donna Walter
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Quick quiz: Which of the following might a debtor consider doing before filing for bankruptcy under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005?

A. buy an expensive car

B. get credit counseling

C. hold off on making charitable contributions

D. all of the above.

The correct answer is D.

Bankruptcy attorneys and courts are still struggling with interpreting the almost-year-old law, but one thing is clear: The changes have led to a number of unintended consequences.

That's because, in contrast to the drafting of the Bankruptcy Code of 1979, the new amendments were not written by lawyers or other bankruptcy experts, according to debtor attorney Wendell Sherk of Sherk and Swope LLC.

"If they had taken each of the constituent interests in the bankruptcy process, a lawyer or two from each side, every side in the system, and told them 'thou shalt make this law tougher on people who are abusing the system,' go to work, it would have taken a month to write something that would do exactly that without throwing out 25 years' worth of jurisprudence," he said.

"But that's not what the lobbyists did," Sherk said. "They specifically excluded almost everybody with real competence in the area. So the net result is you had people who really did not understand the process rewriting the law."

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**Find out more**

The new bankruptcy law will be the subject of three track programs at The Missouri Bar Annual Meeting this week in St. Louis. "How Changes in the Bankruptcy Code Affect Consumers and Creditors" takes place at 2 p.m. today. "Bankruptcy Matters Involving Estates and Trusts" is at 4 p.m. And "What You Don't Know May Hurt You: One Year Later, Bankruptcy Changes and Their Impact on Family Law" starts at 9:30 a.m. Friday.

## Means test

The most contentious issues since the law took effect Oct. 17, 2005, revolve around the application of the means test to disposable income in Chapter 13 cases, according to Sherk. The test is used to determine how much consumer debtors who have income higher than the median income in their state would have to pay back to their creditors, he said.

Tom DeWoskin, principal at Danna McKitrick, talked about the disparity in the application of the means test. A debtor with a business debt of $200,000 and a house with a $150,000 mortgage would not be subject to the means test, but the same debtor with a $250,000 mortgage would be subject to the test because the debtor has more consumer debt than business debt, he explained.

"So whether or not I have to pass the means test is determined by the size of my house. I'm sorry; I just don't see the logic in that," he said.

"This country's supposed to foster entrepreneurs, and here what we're saying is if you're an entrepreneur and you fail, we're not going to protect you," he said.

According to Sherk, the means test has also led to what's known as the "Escalade exception." Above-median debtors with high mortgage payments and large car pay-

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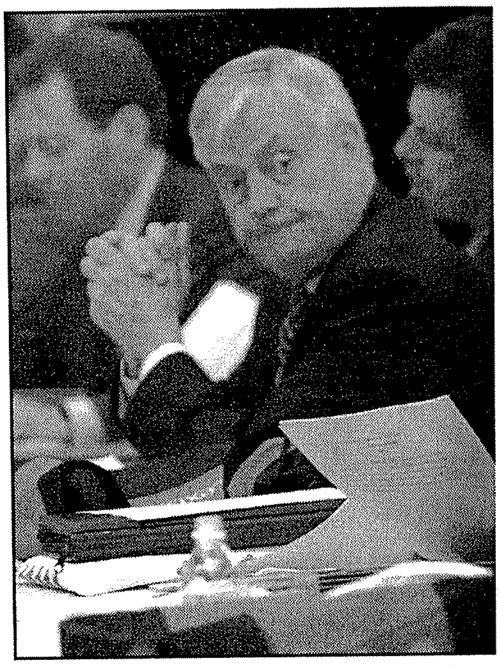

The Missouri Bar Board of Governors meet on
downtown St. Louis. St. Louis County Circuit C
Chazen Friedman are two of the board members i

# Bar will bac prenups, ch

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Premarital agreements, child support and child custody are among the issues The Missouri Bar board of governors has opted to push in the Missouri General Assembly in the upcoming session.

Ann Bauer and Lori Levine, both members of the state bar's Family Law Section, presented three pieces of legislation to the bar leadership for approval.

The bills were all drafted by the National Conference of Commissioners on Uniform State Laws.

Levine asked the board to approve the Uniform Premarital Agreement Act with an eye toward a consistent law both within the state of Missouri and with neighboring states. Missouri currently has no law governing premarital agreements, and, according to Levine, that has resulted in conflicts

# Bankruptcy

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ments may pay little or nothing to their unsecured creditors, while below-median debtors with no car payments may be required to pay back substantially more to their unsecured creditors, he explained.

In addition, the U.S. trustee is taking the position that people who have paid off their cars don't get as large of a deduction on the means test as those who are still paying on their car loans, Sherk said.

"It actually encourages people to have more secured debt whenever they file bankruptcy," he said. "It would not be irrational for them to buy a new car in contemplation of bankruptcy rather than trying to get by with the older used car that they've been keeping so that they can try to pay their bills."

There is no trend in how means test issues are being decided across the country, Sherk said.

**Credit counseling**

The major change in Chapter 7 is the requirement that debtors undergo some form of credit counseling or debtor education, said DeWoskin. The problem he identifies is that the requirement "tries to fit everybody into the same pigeonhole" — regardless of whether the debtor got to the point of filing through frivolous spending, health problems or other life circumstances.

According to Nick Franke, a partner at Spencer Fane Britt & Browne, the issue of when a debtor needs to go through credit counseling has arisen. The 2005 law requires debtors to receive counseling before filing or, if they can't do so, shortly after filing, he said.

In the case of *In re: Keith L. Dixon*, Judge Barry S. Schermer, chief judge of the U.S. Bankruptcy Court in St. Louis, dismissed Dixon's case because Dixon did not receive a briefing from a credit counseling agency before filing his bankruptcy claim. That decision was upheld by the 8th U.S. Circuit Court of Appeals in February.

"So what that means is there's no more of this filing the day before your house is about ready to be foreclosed on because you've got to get this credit counseling out of the way, and generally the waiting time for that is a couple of weeks now. So you've got to plan a lot better if you want to save property from a foreclosure," said Franke.

While Congress intended to make it more difficult to file bankruptcy, "I think the actual legislators would be surprised to find out that people were losing their houses because of the requirement of credit counseling," he said.

**Household expenses**

Questions about what constitutes a household also crop up when lawyers look at the 2005 law.

"The median income that you're allowed to have varies according to your household size," said DeWoskin.

"What is a household?" he asked. "If I'm living with my aged mother and I'm supporting her, is that a household of two? Suppose my aged mother is in an apartment and I'm supporting her, is that a household of two? What about if I've got a kid in college, is that a household of one or a household of two? Or I'm living with my girlfriend and supporting her kid, is that a household of three or two or one?

"We're going to be litigating over nickels," DeWoskin said.

Another household-related issue concerns the expenses allowed to separated couples who file bankruptcy together.

"Are they entitled to only one household's worth of expenses, or do they get the reality of two households' worth of expenses?" asked Sherk.

"The forms don't contemplate this situation. Both sides obviously have differing views about what the code itself says, but realistically the plain language of the code doesn't quite address that issue either. I don't think they thought of it, honestly," he said.

Douglas Walker of Legal Helpers has such a case in the U.S. Bankruptcy Court in St. Louis. "I haven't seen how the United States trustee is going to come out, what kind of answer they're going to have for me. ... I just don't think anybody really has an answer yet."

**Multiple filers**

Poorly drafted provisions on the part of mortgage companies could end up protecting the home of a second-time filer, according to Sherk.

When a debtor who has already filed for bankruptcy files again, the court automatically issues a 30-day stay to protect the debtor and the property, and if that debtor cannot prove a change of circumstances, the stay is automatically dissolved.

There is a question, however, about whether the stay dissolves as to the debtor or as to the debtor and the property, said Sherk.

"It could be read — and has been read by many judges — to say it only dissolves as to the debtor but not as to the property," he said.

"Ironically if it's a third-time filer, if this is your third case that you've been in in the last year, the language is not there, and there is no stay in effect until the court creates one, and there isn't any language that differentiates between the debtor and the property," he said. "So there's a fairly compelling argument that, reading the plain language of the law, that Congress meant to make it worse for the third-time filer even as to their property."

So far, that issue hasn't come up in local Bankruptcy Court, and Dan West of South & Associates said he'd like to keep it that way.

"None of the debtors' attorneys have pushed it here, and I think Judge Schermer has indicated that he would more than likely say that is not the case," West said. Barry S. Schermer is chief judge of the Bankruptcy Court here.

**Charitable contributions**

Just last month, a bankruptcy judge in northern New York issued a decision saying the debtors, a couple that earns more than the median income for a family of three in New York, could not deduct charitable contributions from the bankruptcy estate. The result is an increase in the disposable income for unsecured creditors from $74,351.25 to $80,351.25.

This led Sens. Chuck Grassley, R-Iowa, Orrin Hatch, R-Utah, and Jeff Sessions, R-Ala., to criticize the judge for the "wrongly decided" decision in a letter asking U.S. Attorney General Alberto Gonzales to direct Chapter 13 trustees not to object to the "inclusion of reasonable charitable contributions in a repayment plan" if the contribution meets the requirements of the Religious Liberty and Charitable Donation Protection Act of 1998.

The senators, the lead sponsors of both the 1998 and 2005 laws, wrote, "We can assure you that Congress never intended to exclude reasonable tithing in bankruptcy repayment plans."

Sherk agrees Congress didn't intend to limit tithing, but "that's where it went simply because of the placement of a paragraph in one place rather than another in [Section] 1325 of the new code." The way the Chapter 13 provision is written, said Sherk, appears to allow below-median income debtors to deduct up to 15 percent for charitable giving but does not allow above-median income debtors to do the same thing.

In *In re Diagostino*, Judge Robert E. Littlefield Jr. calls for some clarification from Congress: "The court does not agree with this awkward, bifurcated Congressional framework which makes charitable giving easier for some debtors and not others. Whether tithing is or is not reasonable for a debtor in bankruptcy is for Washington to decide. However, consistency and logic would demand the same treatment of all debtors under Title 11. Until Congress amends §1325(b)(3) [of the 2005 law], the court's hands are tied and the tithing principles that this court once applied pre BAPCPA have been effectively mooted."

"He ruled against the debtors in this case kicking and screaming, I think," said Sherk. "I think he believes he did not have a choice in how he ruled — to disallow their tithing expense."

Franke said there is already talk about Congress amending the BAPCPA to allow tithing deductions.

The same section also prohibits Chapter 13 debtors from paying business expenses, said Franke. That issue hasn't been decided yet, he said.

**Congressional fixes?**

Sherk said he doesn't expect Congress to fix any of the unintended consequences in "the foreseeable future." But then he added that "if things change in November, ... some of the more outlandish anti-consumer provisions might be addressed."

On the other hand, Franke said he expects to see at least one "fix-it amendment" in the next couple of years.

"I think this religious contribution thing is going to drive that," he said. "There's going to be an uproar in various interests groups and religious groups and charitable groups over that. I think it'll drive at least the beginning of the amendment.

"When that happens, you'll have people start tacking on other things like trying to fix this not being able to pay the expenses of a business. There'll be a lot of things like that that'll get tacked on," Franke said.

# Federal Reserve to cut rates in 2007, corporate bond sales show

**By Mark Pittman**
*Bloomberg News*

Thinking about refinancing your mortgage in the United States? Wait a year. Considering a certificate of deposit? Sign up now.

While economists debate whether the Federal Reserve will cut its target interest rate for overnight loans between banks from 5.25 percent, investors have already decided the central bank will reduce borrowing costs next year.

Nowhere is that clearer than in the market for floating-rate notes, whose interest payments rise and fall with central bank policy. Sales of so-called floaters are slowing for the first time since the Fed started raising interest rates in June 2004. They've fallen to $21.5 billion in September from a monthly average of $35 billion this year through August, according to data compiled by JPMorgan Chase & Co.

"People had bought floating-rate debt to be defensive," said William O'Donnell, chief interest-rate strategist at Stamford, Conn.-based UBS Securities LLC, one of the 22 primary dealers of U.S. government securities that trade with the Fed. "Now, they're buying fixed interest to be what I'd call offensive and betting on lower interest rates."

Floating-rate note sales are falling even though they yield an average of 5.61 percent while bonds with fixed interest pay 5.54 percent, according to Lehman Brothers Holdings Inc. in New York. Over the past five years the benchmark for floaters has been higher than 10-year Treasury yields just 15 percent of the time, data compiled by Bloomberg show. Floaters lose value when rates decline because they pay less, while bonds with fixed rates become relatively more attractive.

"We're all buying fixed-rate bonds, something we can get a capital gain out of when yields go down," said James Cusser, who manages $1.4 billion in fixed-income securities at Waddell & Reed Inc. in Shawnee Mission, Kan.

Daniel Fuss, vice chairman at Loomis Sayles & Co. in Boston, who oversees $23 billion and manages the best-performing U.S. corporate bond fund of at least $100 million, says he's "not interested" in floating-rate notes because he expects the Fed to cut rates to 4.50 percent in 2007. The $6.65 billion Loomis Sayles Bond Fund has less than 1.5 percent of its assets in floating-rate notes. The fund is up 8.1 percent this year.

CIT Group Inc., the largest lender through the U.S. Small Business Administration, this month sold $500 million each of 5.8 percent fixed-rate bonds due in 2036 and 5.85 percent of notes maturing in 2016. The 30-year securities yielded 105 basis points more than Treasuries, while the 10-year debt yielded 107 basis points more. A basis point is 0.01 percentage point.

The company switched from floating-rate sales in part because of investor demand, said Treasurer Barbara Callahan.

"You want to sell what the customer wants," Callahan said in an interview. "We have seen a little bit of a cutback in demand for longer-dated floaters. The view out there is that the Fed has paused and they are close to or at the end of the cycle, and that's why fixed-rate debt is becoming more popular."

Finance companies loan more money at variable rates than at fixed costs, so they prefer floating-rate notes to avoid the risk of rising interest rates, said Callahan, who has overseen $15 billion in unsecured debt sales this year.

When CIT sells fixed-rate debt, it usually swaps the rate for floating interest payments, according to Callahan. Based on the 10-year sale, the New York-based company paid 7 basis points more than the fixed-rate bond's coupon, or 5.92 percent, to swap the payments to a floating rate, Callahan said. That's an extra $350,000 a year in interest on $500 million.

Residential Capital Corp., the mortgage unit of Detroit- based General Motors Corp., turned to fixed-rate debt for its last bond offering May 11.

ResCap, as the company is known, sold $1.15 billion of 5.125 percent securities maturing in 2012 and 6.375 percent notes due in 2013. The securities were denominated in pounds and euros. ResCap in April paid 7.3 percent to sell $1 billion of three-year floating-rate debt in dollars.

"You want to issue into strength, and that strength comes from demand," said Louise Herrle, the treasurer of Minneapolis-based ResCap.

Goldman Sachs Group Inc., the most-profitable U.S. investment bank, paid an initial coupon of 5.84 percent when it sold $2.5 billion of 10-year floating-rate notes in March. The firm offered $1.5 billion of 5.75 percent fixed-rate notes due in 2016 on Sept. 14. The difference represents a savings of $1.5 million a year in interest on $2.5 billion.

Goldman expects the Fed to reduce interest rates to 4 percent by the end of next year, according to Edward McKelvey, the firm's senior U.S. economist.

Demand for floating-rate notes increased when the Fed began raising rates from a 45-year low of 1 percent two years ago. Sales jumped 50 percent to $286 billion in 2004 from $190 billion the year before, according to JPMorgan, the biggest underwriter of U.S. bonds. They climbed to $299 billion in 2005 and reached a record $301 billion so far this year.

Sales slowed after the Fed left interest rates unchanged on Aug. 8. Fed funds futures traded on the Chicago Mercantile Exchange reflect about a 40 percent chance the central bank will lower its target rate to 5 percent by the end of January.

Economists are less certain about the direction of interest rates than money managers, who are snapping up U.S. government debt. The yield on the U.S. 10-year note tumbled to 4.54 percent yesterday from 5.25 percent in June. By contrast, 34 of the 72 economists in a Bloomberg survey published Sept. 8 predict rates will end 2007 at 5 percent or higher.

Merrill Lynch & Co. and Goldman, the two big Wall Street firms that predicted the rally, are telling clients to buy two- year Treasuries to prepare for Fed rate cuts next year. Some of the other big investment banks disagree. Bear Stearns & Co. says rates will reach 5.75 percent by the end of 2007, while Lehman predicts 5.50 percent and Morgan Stanley anticipates 5.25 percent. All the firms are in New York.

U.S. growth will slow to 2.7 percent, according to the median estimate in the Bloomberg survey, compared with the average of 3 percent over the past two years.

"The markets are telling us that the Federal Reserve is going to cut rates in the middle of next year," David Wyss, S&P's chief economist, said in an interview from his office in New York. The Fed will have to lower rates because "the economy is going to cool off faster than they thought."