THE BEGINNING OF A NEW CHAPTER

Going for BROKE

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Bankruptcy law will make debt harder to erase

By WAYNE HEILMAN THE GAZETTE

Filing for bankruptcy will become more difficult and expensive next week for individuals and businesses, causing a run this month on bankruptcy court by debtors trying to get in under the gun.

In addition, some experts fear the new law will make would-be entrepreneurs think twice before bringing forth innovative ideas.

Beginning Oct. 17, debtors who file for bankruptcy face tougher requirements under a massive revision in federal bankruptcy laws. The new law, among other mandates, requires debtors who have the ability to repay their bills to make monthly payments to creditors for up to seven years and to take credit counseling courses.

To escape having to pay back creditors, hundreds of debtors in the Springs and and thousands nationwide have filed for bankruptcy in recent weeks and months. The 30,256 filings received this year through Thursday already shattered the record set for last year.

On Wednesday, the U.S. Bankruptcy Court in Denver received 521 filings, a one-day record, and more are expected this week.

The number of business and personal bankruptcies in Colorado has increased each year since 2001 as the state and the nation have become a debtor society.

The reasons are many.

Often, business owners end up in bankruptcy court after accumulating thousands of dollars in debt trying to save failing businesses, according to a recent study by the Harvard Law School and University of Nevada at Las Vegas.

In addition, individual bankruptcies sometimes are triggered by personal guarantees small-business owners make to get loans and other types of credit for their companies, said Jim Chadderdon, a local bankruptcy attorney who specializes in small-business filings.

“Many of the Chapter 7 cases I handle are people who can’t keep their business going,” Chadderdon said. “A lot of these guys used their personal credit cards to finance their businesses. It is part of the American ‘never-say-die’ entrepreneurial spirit.”

Huge medical bills, rather than creditcard debts, lead to more than half of personal bankruptcy filings, according to the Harvard study released in February. Job losses and divorce also trigger many filings, local bankruptcy attorneys said.

THE 7-YEAR SPIN

Bankruptcy filings are expected to slow to a trickle when the new law takes effect and attorneys, judges and others sort out how the new system will work.El Paso County ranks second in the state behind Arapahoe County, with 2,722 Chapter 7 business and personal bankruptcy filings during the first eight months of the year. That’s up 3.3 percent from the same period a year ago. Under Chapter 7, most of the business’ or individual’s assets are sold to repay creditors.

El Paso County led Colorado with 3,324 Chapter 7 filings last year, helping the state set a record with nearly 28,000 bankruptcy filings of all types. The Gazette compiled Chapter 7 bankruptcy filing totals by county for 2004-05 from U.S. Bankruptcy Court records.

Bankruptcy lawyers said local bankruptcies may be high because of more than 40,000 military personnel stationed at bases in the county. Many lower-ranking soldiers struggle to make ends meet because most of the local military community lives off-base, local attorneys said.

“This law is beneficial to creditors, no doubt about it,” said Ron Martin, a lawyer with Holland & Hart LLP and a national expert on bankruptcy law. “The creditcard industry lobbied hard for this bill and they have put themselves in a much better position to collect. They are in a lucrative industry that is becoming more lucrative.”

In the most significant change under the new bankruptcy law, people who make more than the state’s median income — $40,044 for individuals in Colorado — won’t be able to erase debts in bankruptcy. Instead, they will have to make monthly payments to creditors for up to seven years.

The amount of the payment will depend on how much money the debtor has left over after living expenses; the new law requires that those who have at least $100 left must make the monthly payments.

ENTREPRENEURIAL DETERRENT?

Tougher bankruptcy laws may make entrepreneurs more reluctant to start new companies, Holland & Hart’s Martin said.

“The price of failure will get a lot higher on (Oct. 17),” Martin said. “Those who come up with innovations and new ideas and start companies to bring those innovations and ideas to the marketplace may be reluctant to do so without being able to make a fresh start,” if the business fails and they must pay creditors back.

“Our economic system needs to encourage entrepreneurs to make new investments,” said Elizabeth Warren, a Harvard Law School professor and co-author of the study along with Robert Lawless, a law professor from the University of Nevada at Las Vegas.

“Sometimes these investments will fail through no fault of their owners, and when that happens, the owners need to be able to move to other businesses and create new jobs and investment opportunities,” after filing for bankruptcy, Warren said in the study.

Some local experts disagree that the new law will hold back entrepreneurs.

Gary Markle, chief executive of the Colorado Springs Technology Incubator for startup companies, doesn’t believe tougher bankruptcy laws will discourage entrepreneurs from starting new firms.

“Most entrepreneurs are betting the farm already on their idea and aren’t concerned about whether or not they can file for bankruptcy,” Markle said. “They are focused on building a company, so I really don’t think the new law will affect them that much.”

John Jackson, a local banker who lobbied for 10 years for the law, said most entrepreneurs use loans from friends and family, rather than credit cards, to start businesses.

“That is a risk they take” in starting new businesses, said Jackson, president of First State Bank Mortgage in Colorado Springs. “Borrowers who repay their loans are paying for this with much higher rates on credit cards due to losses from bankruptcy.”

Gazette researcher Annie Mullin
contributed to this report.

CATEGORIES OF BANKRUPTCY FILINGS

Individual and business debtors can file two types of bankruptcies, and a new federal law that takes effect Oct. 17 changes how those filings will work:

CHAPTER 7

c A trustee appointed by the U.S. Bankruptcy Court sells most of the debtor's assets to repay creditors; remaining debts are wiped out. c Both individuals and businesses can file a Chapter 7 bankruptcy. Beginning Oct. 17, debtors with incomes above the state median income, $40,044 for individuals and $54,187 for couples in Colorado, will not be able to file a Chapter 7 bankruptcy unless they can prove special circumstances to the court.

CHAPTER 11

c Businesses can file for bankruptcy court protection from their creditors while they come up with a plan to repay some or all of what they owe. Under the new law, businesses will have six months to come up with that plan before creditors create their own plan. The new law also limits bonuses paid to executives by firms operating under Chapter 11 and gives businesses seven months to decide whether they want to void leases and other contracts.

CHAPTER 13

c Beginning Oct. 17, individuals who can afford to repay at least $100 a month after living expenses or have incomes above the state median, or midpoint, will have to file a Chapter 13 bankruptcy, under which they agree to make monthly payments to creditors for up to seven years.

CHAPTER 9 and CHAPTER 12

c These chapters are not available to individuals or businesses. They are reserved for local governments (Chapter 9) and family farmers (Chapter 12). A handful of special taxing districts in El Paso County filed Chapter 9 bankruptcies in the late 1980s and early 1990s.

FEATURES OF NEW BANKRUPTCY LAW

The most sweeping rewrite

of U.S. Bankruptcy Code in a quarter century, making it harder for debtors to erase credit-card and other obligations in court proceedings, goes into effect Oct. 17. The legislation was passed by Congress and signed into law by President Bush in April after an eight-year campaign by banks, retailers and credit-card companies.

A major provision

of the new law sets up an income test to determine whether people can have their debts canceled in exchange for forfeiting certain assets or if they must repay them under a court-ordered plan.

The change will affect

30,000 to 210,000 people a year. There already has been a rush to the courthouse by those wishing to file for bankruptcy under the current law, which generally allows federal bankruptcy judges leeway to determine the fate of debtors' assets and how much they must repay.

Financial services companies

and other proponents of the change have maintained that the bankruptcy process has been abused by gamblers, compulsive shoppers and others who were able to shelter assets from creditors. They say the abuse has resulted in higher interest rates for everyone else.

Opponents have said

the new law will fall especially hard on low-income working people, the elderly and others and will remove a safety net for those who have lost their jobs or face mounting medical bills.

AMONG THE CHANGES IN THE NEW LAW

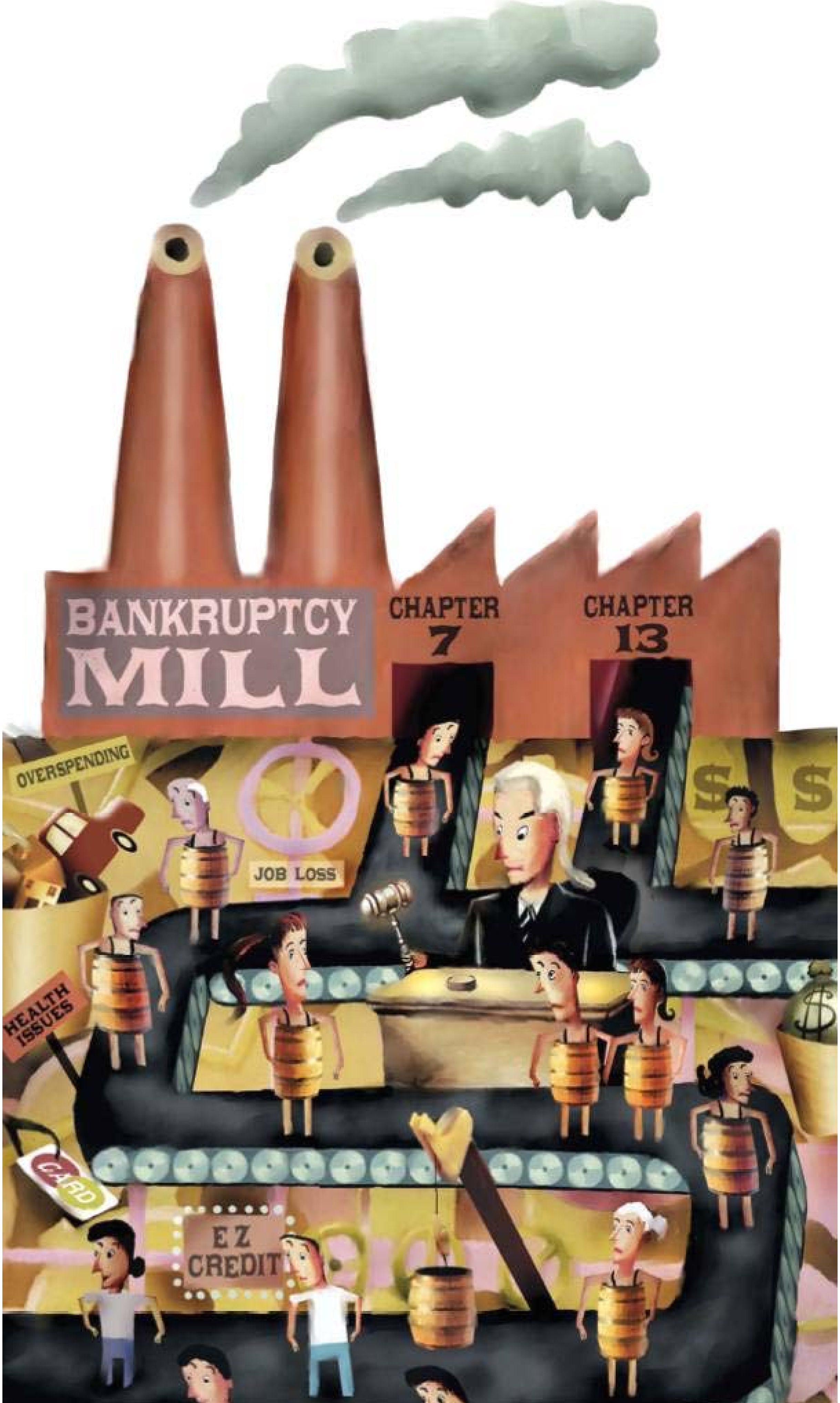
c A test will measure a debtor’s ability to repay. People with insufficient assets or income can still file a Chapter 7 bankruptcy, which — if approved by a judge — erases debts entirely after certain assets are forfeited. Those with incomes above their state’s median income who can pay at least $6,000 over five years — $100 a month — will be forced into Chapter 13, under which a judge orders a repayment plan.
c People seeking bankruptcy protection are required to take credit counseling courses within 180 days of filing.
The U.S. Trustee’s Office has approved only four nonprofit groups to offer that counseling in Colorado, and none have offices in the state. For now, debtors will have to get the counseling, which must be at least 90 minutes long, either by phone or via the Internet.
c It gives priority to a spouse’s claims for child support among creditors’ claims on a debtor in bankruptcy.
c It allows for special accommodations for active-duty service members, lowincome veterans and those with serious medical conditions in the new income test for bankruptcy applicants.
c It also requires billing statements for credit card accounts to include an example of how long it would take to pay off a balance at a specific interest rate if only minimum payments are made.

BUSINESS BANKRUPTCY PROTECTION

c The law limits the exclusivity period, the 18-month span during which a company in Chapter 11 has the sole right to propose a reorganization plan. Debtor companies are no longer given unlimited extensions of the exclusivity period. c It limits the ability of companies to give lucrative pay packages as a way of retaining top executives. c Companies must decide within 210 days, or seven months, whether they will keep or relinquish leases on property. c Creditors can seek to have a Chapter 7 liquidation filing dismissed or converted to a debt reorganization plan under Chapter 11.

ON THE NET

Information about the new bankruptcy law, Public Law No. 109-8, can be found at http://thomas.loc.gov


BANKRUPTCY MILL
CHAPTER 7
CHAPTER 13
OVERSPENDING
JOB LOSS
HEALTH ISSUES
CARD
E Z CREDIT

KNIGHT RIDDER TRIBUNE