

Personal Bankruptcies



Kevin P. Casey for the New York Times

Bankruptcy is a procedure allowing debtors, both households and businesses, to eliminate some bills and repay others over time.

While bankruptcy is generally seen today as a protective measure for debtors, its ancient roots are punitive, a remedy on behalf of creditors. Early United States bankruptcy laws did not provide for a discharge of debts by debtors, only a liquidation of their assets. The roots of modern American bankruptcy are found in Congress' Bankruptcy Act of 1898.

The Department of Justice's United States Trustee Program oversees administration of bankruptcy law. There are five chapters of United States bankruptcy law, which apply to different situations:

Chapter 7: Used by consumers and businesses, it eliminates many debts such as credit card and medical bills not secured by collateral, in exchange for the liquidation of assets not protected by federal or state exemption laws.

Chapter 13: A debt reorganization plan chiefly used by individuals who want to keep possession of assets such as homes and cars by becoming current on delinquent loans and repaying unsecured debts according to their means.

Chapter 11: A debt reorganization and pay-back plan mostly used by businesses but also some consumers with too much debt to qualify for Chapter 13.

Chapter 12: Resembling chapter 13, designed for family farmers and fishermen.

Chapter 15: Added to federal law by Congress in 2005 to codify law governing business bankruptcy cases involving parties in more than one country.

The most recent significant change was the Bankruptcy Abuse Prevention and Consumer Act of 2005. It was passed at the urging of the credit industry which said reform was needed to stop consumers using bankruptcy to walk away from debts they could afford to repay.

The chief feature of the act is a means test for consumers who make more than their states' median income. If the test, which takes into account income and expenses, deems that these debtors can repay a minimal amount of their unsecured debt over five years, their Chapter 7 cases are subject to dismissal. Their only other bankruptcy remedies are Chapter 13 or a far costlier Chapter 11.

Many consumer advocates and bankruptcy professionals contended that the 2005 law, by making bankruptcy more expensive, difficult and less effective, was intended to discourage filings by all consumers. Total filings in 2007, the second full year after the act's passage, were only about half the 1.6 million filings in 2004, the last full year before the act. Still, filings were climbing in 2007, and in early 2008, economic experts predicted that total filing would exceed 1 million by the end of that year because of growing consumer debt and financial repercussions of the home mortgage crisis.

Also in early 2008, in response to the growing crisis in home foreclosure, Congress was considering legislation that would allow judges in Chapter 13 cases to lower interest rates and amounts owed on primary residences. Current law allows for such modifications for secured loans for second homes, some cars, yachts and jewelry. The financial services industry opposes the legislation on the ground it would raise mortgage rates for other consumers in the future and further disrupt the global securities market.

-- Jane Birnbaum, Jan. 11, 2008