

THE WHITE HOUSE

WASHINGTON

June 22, 2000

MEMORANDUM TO THE PRESIDENT

FROM: GENE B. SPERLING/SARAH ROSEN WARTELL
CHARLES BRAIN/JOEL WIGINTON

SUBJECT: DECISION ON BANKRUPTCY REFORM LEGISLATION

CC: JOHN PODESTA

ISSUE PRESENTED:

Senator Lott has advised Senator Daschle that negotiations on bankruptcy reform legislation are over. The Republicans agreed to make some further concessions on a couple of the outstanding issues, but the final resolution fails to address our concerns on three key issues you noted in your recent letter to the Congressional leadership: the homestead exemption, discharge of penalties for violations of clinic access laws, and an exemption from the Fair Debt Collection Practices Act (FDCPA) for check collectors. These problems come on top of the dissatisfaction many of your advisors feel with the balance struck in the bill's other provisions. Senator Daschle has asked about your intentions and believes that a strong, clear message from you quickly could enhance the chances of obtaining a veto-sustaining margin.

Your advisors unanimously recommend that you send another letter to the Congress that: (1) indicates that you will veto the bill that Lott described as final; (2) strongly implies that you will sign no bill without adequate clinic access provisions; (3) stresses your concerns with the current resolution of the check collector and homestead issues and the lack of balance in the remainder of the bill; but (4) urges the Congress to fix these problems and leaves you room to decide how to proceed if the clinic access issue is resolved.

STATUS IN CONGRESS

Senator Daschle believes that the chances of achieving 34 Democratic votes are enhanced by your sending a clear, strong veto message as soon as possible. However, it is not certain that a veto-sustaining margin can be obtained. While Daschle would personally support the bill in its current form, if you have a strong veto message premised upon the clinic access and check collector provisions, Daschle may stand with you. Nonetheless, there is some risk, as we have never heard a credible assertion that even 25 Democrats are willing to oppose the bill.

Senator Torricelli, the lead Democratic sponsor of the legislation, also appears to be inclined to support the bill in its current form. Torricelli's staff, however, notes that if you come out with a clear and strong veto statement, the Senator may stand with you against the clinic access and check collector provisions.

Eleven Democratic Senators were opposed to the bill on relevant grounds when it passed the Senate. Senator Durbin, who led the bipartisan effort last year and voted for the Senate bill, has determined that the final bill is unacceptable to him, regardless of the outcome of these remaining issues. Senator Leahy, who voted for the Senate bill and has worked hard to ensure a fair process, believes that the clinic access and the check collector issue swing the balance against an already flawed product; he will vote against it in this form and recommend a veto. Senator Schumer, who strongly opposes the bill, believes that the clinic access issue will mobilize others.

There are five to seven Democrats, led by Senators Biden, Johnson, Breaux, and Reid of Nevada, however, who will likely support the bill in whatever form it is presented to them. Senator Jeffords is the only Republican who has publicly noted some concerns with the measure.

There is little prospect for overcoming the strong veto-proof margin of 313 to 108 by which the House passed its bill last May. Moreover, it is likely that the Republicans will send whatever vehicle they use for the bankruptcy bill to the House first to try to gather momentum.

ADMINISTRATION APPROACH TO BANKRUPTCY REFORM

We have said repeatedly that you support balanced consumer bankruptcy legislation that would encourage responsibility and reduce abuses of the bankruptcy system on the part of debtors and creditors alike. We can eliminate abuse without hurting those forced to turn to bankruptcy, the vast majority of whom are faced with some of the hardest circumstances that life has to offer - divorce, unemployment, illness, and uninsured medical expenses. Although we should not countenance people using bankruptcy to escape bills they can afford to repay, we also should not enact punitive legislation that places insurmountable barriers before the people who file for bankruptcy as a last resort.

To guide Congress in striking the proper balance, we have set forth principles that should be met by a final bill. Many of these issues were resolved on a bipartisan basis by Congressional staff. Others were reserved as "member issues." Just this week, Lott advised Daschle of the Republicans' final offer on these issues and their plan to move forward attaching bankruptcy to the next available vehicle.

ASSESSMENT OF NON-MEMBER ISSUES

In a letter to the informal conferees on May 12, 2000, Jack Lew set forth your key principles. A detailed assessment of the resolution of these issues is in the attached appendix.

In short, the final bill's provisions are closer to the Senate bill than the House bill, but they do not incorporate the balance that you have sought. They reflect a compromise between a House bill that we thought badly one-sided and a better Senate bill about which we still had significant concerns. While all of your advisors believed when we wrote you on May 5th that you should sign a bill close to the Senate bill, this bill is a somewhat closer call.

For example, our fundamental concern about the rigidity of the means test in the Senate bill was not addressed. Moreover, changes were made from the Senate bill to shift a few more debtors out of Chapter 7 and limit a bit further the court's discretion to determine whether a debtor has the capacity to repay. Similarly, flawed language from the Senate bill narrowly limiting the family household goods that debtors can protect from creditor seizure was included in the final bill. While no one of these provisions alone merits your veto, cumulatively they represent undesirable changes relative to the Senate bill.

ASSESSMENT OF RESOLUTION OF MEMBER ISSUES

You wrote to Congressional leaders on June 9th setting out your concerns about five open member issues. Our assessment of the resolution of these issues is below. In short, we believe two of those issues have been resolved to our satisfaction (pension cap and credit card disclosures, although Senator Kennedy is having trouble getting confirmation of the agreement on pension cap); one issue has been resolved to the satisfaction of key Senate Democrats but not to ours (homestead); and the Republican resolution of two issues (clinic access and check collector exemption) is unacceptable to us and the lead Democrats on those issues, although some Democrats would support the bill nonetheless.

Pensions: "The final bill may eliminate protections for reasonable retirement pensions that reflect years of contributions by workers and their employers."

The Senate bill included a noxious provision that would have allowed creditors to demand that debtors waive bankruptcy protection for pension assets as a condition of receiving credit. That was dropped in Conference, but Senator Grassley insisted on some limit on otherwise unlimited pension assets shielded from creditors. Senator Kennedy was deeply concerned that such a cap would send the wrong message about retirement savings. Moreover, seemingly large retirement accounts do not necessarily provide for extravagant lifestyles for workers with increasingly long life expectancies. A compromise was apparently reached between Kennedy and Grassley that caps only certain IRAs, excluding amounts rolled over from employer pension plans, at \$1 million. Moreover, the court has discretion to waive the cap in the interests of justice. Senator Kennedy is having difficulty getting confirmation that the Republicans will stick with this agreement. *If there is no backsliding, this resolution seems reasonable and consistent with our arguments in the homestead context.*

Credit Card Disclosures: "The final bill may weaken important credit card disclosure provisions that will help ensure consumers understand the implications of the debt they are incurring."

The Senate bill requires modest new credit card disclosures. Consumers would be given better information about credit card "teaser rates" and the impact of making only the minimum payment on the length of time one would be repaying debt. Your letter referred to an effort by Senator Gramm to exclude small banks from the provisions' scope. However, the provisions survived without the exclusion, although for two years the Federal Reserve Board will be asked to provide consumers with an 800 number for information about credit cards issued by smaller banks - an 800 number that larger banks will have to provide themselves. *The Senate bill's modest disclosure requirements have been effectively preserved.*

Homestead: "The final bill may not adequately address the problem of wealthy debtors who use overly broad homestead exemptions to shield assets from their creditors."

State law allows debtors to exempt from the bankruptcy estate home equity valued up to specified homestead exemption thresholds. Five states (including Texas and Florida) have unlimited homestead exemptions, effectively allowing wealthy debtors to shield millions in assets in valuable mansions, while avoid repayment of their creditors. It seems to us fundamentally unfair to ask low- and moderate-income debtors to devote future income to repay all the debts that they can, while leaving loopholes that allow the wealthy to shield assets from their creditors.

The final bill has a modest limitation on unlimited homesteads to address abuse by those who move to states with unlimited homestead exemptions within two years of the bankruptcy filing. *This does not address our fundamental issue.* Moreover, wealthy debtors often can use bankruptcy planning to postpone bankruptcy for two years while they qualify for the unlimited homestead exemption.

Senator Kohl, the Democratic Senate champion of this issue, is satisfied that this resolution represents a good first step and establishes the principle that some nationwide limitation on homestead exemptions is appropriate. (Kohl is undecided whether he will support or oppose the overall bill.) Senator Leahy does not want to flank Senator Kohl on the left on this issue. Thus, if you take this issue to the public, you will have only long-time bankruptcy-bill opponents like Wellstone, Kennedy, and Nadler joining you from Congress. However, many editorial pages around the country have pressed this issue hard and would applaud your concern.

Fair Debt Collection Practices Act: "The final bill may include an anti-consumer provision eliminating existing law protections against inappropriate collection practices when collecting from people who bounce a check."

In conference, Senator Hatch has insisted on an anti-consumer provision (in neither the House or the Senate bill) which would eliminate attorneys fee awards for violations of the Fair Debt Collection Practices Act, if the defendant is collecting bounced checks rather than other defaulted debt. This is a pernicious provision because it could give check collectors de facto rein to intimidate and harass lower-income debtors, knowing that their financial position would prevent them from hiring counsel. Often, the only effective enforcement of the check collector provisions is class action litigation, financed by firms because of the potential for attorneys fee awards. Senator Torricelli suggested a minor change, which the Republicans accepted, that limits attorneys' fees to cases where the debtor can prove that he or she had no intent to defraud. Senators Leahy and Sarbanes argue that such a standard is impossible to prove. *Our fundamental concerns have not been addressed.*

Clinic Access: "Some in Congress still object to a reasonable provision that would end demonstrated abuse of the bankruptcy system. We cannot tolerate abusive bankruptcy filings to avoid the legal consequences of violence, vandalism, and harassment used to deny access to legal health services."

The Senate bill included a Schumer amendment to address the announced strategy of anti-abortion protestors using bankruptcy to avoid penalties for violence against family planning clinics in violation of the Freedom of Access to Clinic Entrances Act (FACE) and its state counterparts. We strongly supported the amendment. The Vice President was in the Senate chamber when they voted to break a tie, if needed. To avoid embarrassment, the Republicans ensured that the amendment passed by a vote of 80-17. However, in conference, they have steadfastly refused to include it or a comparable measure. Their alternative, which they have unilaterally announced will be in the final bill, does little beyond current law. It precludes discharge of all judgements for acts of violence where behavior was shown to be willful and malicious. Advocacy groups argue that few of the actual judgements against, or settlements reached with, defendants who harassed clinic patients include a finding of willful and malicious behavior. Moreover, harassment and intimidation does not always include violence. *Thus, the final unilateral resolution does not satisfy our concerns.*

This is the hardest issue for the Democrats who want to support the bill. Abortion rights groups are energized. If you take a strong position, this is the issue most likely to rally Democrats in opposition to the bill. Even Senator Torricelli may join you in opposing the bill if further changes are not made to this provision, although Senator Biden does not believe this issue should bring down the entire bill.

RECOMMENDATION

Your advisors unanimously recommend that you send another letter indicating that the Republicans' "final" bankruptcy bill is one that you would veto. The letter would note that there has been an acceptable resolution on pensions and credit card disclosures, but that you have continuing concerns about the check collector, homestead, and clinic access provisions. Special emphasis will be given to the clinic access issue, so that no one reading the letter would doubt you would veto any bill without its satisfactory resolution. A reader should also be concerned that you might veto a bill that does not resolve the homestead and check collection issues to your satisfaction, but the letter will give urge the Congress to fix these problems and give you sufficient latitude to make the veto decision later. There is a real risk that Congress could resolve the clinic access issue, leaving you with only a handful of Democratic Senators joining you in opposition to a bill with the other provisions.

DECISION

- 1. Send the letter as proposed
- 2. Let's discuss

APPENDIX
ASSESSMENT OF BANKRUPTCY BILL'S OTHER PROVISIONS

In a letter to the informal conferees on May 12, 2000, Jack Lew set forth your key principles. Our assessment of the resolution of these issues is below.

Means Test: "Access to Chapter 7 should not be governed by an arbitrary means test, but by reasonable guidelines that take into account individual circumstances."

We have argued unsuccessfully that various changes are needed to build more discretion into the system to determine whether, in the debtor's individual circumstances, they really have the capacity to repay. We have also sought less stringent thresholds and various technical changes to prevent unfairness in the application of the test. We did succeed in preventing creditors from filing motions to challenge low-income debtors' bankruptcy filings, but these below-median income debtors will be subject to the burdens of new means test paperwork and trustee scrutiny even though only a tiny fraction will have any capacity to repay their debts. While some modest improvements were made in conference, *the final bill (like both House and Senate bills) does not address many of our fundamental concerns.*

Protection Against Coercive Reaffirmations and Practices: "There must be appropriate safeguards against coercive creditor practices that compel debtors to forgo their rights and that disadvantage more scrupulous creditors."

During bankruptcy, too many debtors are misled or deceived into agreeing to repay debts that they cannot afford and have a legal right to discharge. The final bill contains provisions, based on an Administration proposal, that make it significantly more difficult to mislead or deceive debtors who cannot afford to reaffirm their debts. To get our proposal included in the Senate, we had to make some significant compromises with the credit card industry that cause consumer advocates concern. We sought further improvements in conference but they were not made. However, truly offensive provisions from the House bill (that would have banned class actions as a remedy for existing law violations) were dropped. As a whole, your staff believe *these provisions are a net improvement for consumers over current law.*

Improving Credit Card Practices: "Both debtors and creditors must be required to be responsible. Bankruptcy reform should be balanced by including provisions that address credit-card practices that may lead to bankruptcies."

As discussed in the body of the memorandum, modest new credit card disclosure requirements were included in the Senate. These largely survived in tact in the final bill. Consumers are given better information about credit card "teaser rates" and the impact of making only the minimum payment on the length of time one would be repaying debt. *Overall, while we believe more information could be provided more clearly, these provisions are an improvement over current law.*

Non-dischargeable Debts and "Cram Downs": "The goal of repaying creditors must be balanced with the need to protect social priorities, such as payment of child support, alimony, and taxes, and to preserve a meaningful opportunity for a fresh start."

In the last Congress, the First Lady wrote of her concern with provisions that make additional credit card debt nondischargeable in bankruptcy, thus leaving it to compete with higher societal priorities that also are nondischargeable -- especially payment of child support and alimony.

In response, the bill's proponents left the new categories of nondischargeable credit card debt, albeit somewhat narrower, but added provisions to clarify that child support and alimony are the highest priority. These provisions will work in many cases to improve the payment of child support and alimony in bankruptcy; however, in a small portion of cases after bankruptcy discharge, these new nondischargeable credit card debts could crowd out child support or alimony. Our argument is very technical, however. *Rhetorically, they have neutralized our child support and alimony criticism.*

We have a similar concern about provisions in the final bill that would give secured creditors unprecedented rights to collect amounts in excess of the value of their collateral. (Current laws "crams down" their claim to the value of the security. Thus, if a car is worth less than the amount originally borrowed, the claim is limited to the car's value.) Since secured debt must be satisfied if the collateral is to be kept, collection of other societal priorities (like child support, alimony, and taxes) might also suffer a bit. The bill also skews the distribution of scarce debtor assets toward undersecured creditors instead of unsecured creditors (like credit card companies). The latter firms support is ironic, but this was a political bargain they made with car financing firms to win Senator Abraham's support. While the final bill is better than the House provisions, *our fundamental concern was not addressed.*

Barriers to Entry or Representation in the Bankruptcy System: "Inappropriate barriers should not be created to entry into or effective representation in the bankruptcy system."

The Administration has been concerned about inflexible pre-bankruptcy filing hurdles, including paperwork and counseling requirements and fees. We were also concerned about attestation requirements and sanction provisions that could deter attorneys from representing debtors or raise the costs of representation. The final bill waives fees for low-income debtors, reduces some of the paperwork requirements, and eliminates the most chilling requirements for debtors' attorneys. *While hardly the provisions we would have written, we do not have strong objections to the remaining provisions.*