Bankruptcy protection law in US With focus on The Bankruptcy Abuse Prevention And Consumer Act Of 2005

Saud Hamoud Alharthi
shharthi@uqu.edu.sa
Faculty of Judicial Studies And The Regulations – Law Department, Umm Al-Qura University, Makkah, Saudi Arabia

Abstract
Bankruptcy is one of the major areas that have attracted the interest of many researchers in the American system, particularly in terms of the laws that oversee it. It provides a plan of reorganization that enables the debtor or the proprietor to discharge liabilities to the creditors through dividing the assets to settle debts. This activity is carried out under supervision to fairly protect the interests of the creditors. Bankruptcy protection systems are dynamic and complex in nature, in line with the economic sector, ensuring the protection of affected individuals from falling into huge losses. Some bankruptcy procedures give the debtor the opportunity to stay in operation or business activity and benefit from revenues until the debt is settled. This law allows some debtors to be relived from any financial burden after the distribution of assets, even if the debt is not paid in full. In light of the above information, this research paper seeks to explore the nature of the complexity of bankruptcy protection laws, their characteristics, and the justice system that regulate them. It also sheds more light on the decision-making powers on bankruptcy cases. There are specialized courts that cover bankruptcy cases located in district courts in every state.
Keywords:
Bankruptcy, Consumer, protection, Act.

1. Introduction

In the United States, bankruptcy is an area that has attracted major research interest, especially in terms of the law governing it. With focus on *The Bankruptcy Abuse Prevention and Consumer Act of 2005* it emerges that the law formulates a plan, which makes it possible for a debtor, who is not in a position to pay the creditors, to divide the assets he has amongst the creditors as a means of resolving the debts. Underlying the Detroit bankruptcy case, it is evident that *The Bankruptcy Abuse Prevention and Consumer Act of 2005* inspires a robust framework that ensures that the interests of the creditors are met and handled in as manner that ensures some level of equality. To illustrate, it is plausible to note that the key to eligibility for U.S. Chapter 9 bankruptcy protection for Detroit, as it is for any municipality, lies in proving the city is insolvent and has negotiated in good faith with creditors. This paper explores the Bankruptcy Abuse Prevention and Consumer Act of 2005 within the spectrum of bankruptcy laws in the US. The paper draws largely on the Detroit Bankruptcy case to make its analysis and conclusion.

Manuscript received May 5, 2022
Manuscript revised May 20, 2022
https://doi.org/10.22937/IJCSNS.2022.22.5.30

Methodology

This study is based on a descriptive approach to the problem of the absence of legal regulation to Bankruptcy protection law in US . Additionally, it adopts the analytical method, which relies on gathering information, facts and legal texts and judicial rulings related to Bankruptcy protection law in US and then analyzing them to determine their suitability for application to particular problems. The study will also compare the laws of other Arab countries, the UNCITRAL model law and the agreements and guidelines on consumer protection to reach conclusions and recommendations for better consumer protection.

The Bankruptcy Abuse Prevention And Consumer Act Of 2005

The underlying issue that emanates from the *Bankruptcy Abuse Prevention and Consumer Act of 2005* informs the argument that some bankruptcy proceedings make it possible for the debtor to remain in operation and utilize the revenue emanating from the business to settle the debts. Additionally, the reason for the bankruptcy law, is to enable some debtors to be free of any financial obligations they might have accrued, following the distribution of their assets, even in case where there debts are not completely paid (Nathalie, 2008). This has the implications that this law opens up a framework that protects the overly integrity of the US bankruptcy system through a mechanism of not only overseeing litigation within the enforcement of bankruptcy laws but also provide for a case administration procedure. In light of this, Eber (2012) outlines that this law represents an important new development in the Program's continuing efforts to improve bankruptcy processes and procedures by enhancing efficiency, integrity and effectiveness of bankruptcy laws.

Notably, the failure by *The Bankruptcy Abuse Prevention and Consumer Act of 2005* to protect the right of the debtor to file for bankruptcy in a voluntary manner led to major public displeasure which led to the repealing of the act three years later. Fray (2007) asserts that given the dynamic nature of law in the country, the act was in 1803 repealed. Philosophical debates relating to the side that the bankruptcy laws should offer protection (that is, whether it was the debtor or creditor) led to the struggle in Congress for the next four decades to enact uniform federal bankruptcy law. Diplomatist Edmund Roberts, who was the envoy to the Far East under President Andrew Jackson's government, integrated American concept of bankruptcy protection "Article VI of the Roberts Treaty with Siam of 1833" (Nathalie, 2008, 17). The Acts of 1841 and 1867 were the first ones to allow voluntary bankruptcy in the country. Together with the Bankruptcy Act of 1898 (the Nelson Act), these early acts created the modern idea of debtor-creditor relations. The enactment of these acts provided greater protection to the debtor. The Acts of 1841, for the very first time allowed the debtor to file for bankruptcy in a voluntary manner (Eber, 2012).

Within the historical comparative understanding it is arguable that *The Bankruptcy Abuse Prevention and Consumer Act of 2005* mirrors Chandler Act, which is the Bankruptcy Act of 1938, in the breadth that the two pieces of legislations extended the voluntary access to the system of bankruptcy, with the voluntary petitions becoming more favorable to the debtors. The Securities and Exchange Commission was given authority by the Chandler Act to administer bankruptcy filings. The area of bankruptcy protection in the United States has been dynamic and kept on changing with various enactments and amendments of the law. The most recent exercising of the mandate by congress to enact laws relating to bankruptcy was exercised most recently by the enacting of the Bankruptcy Reform Act of 1978 (Frey, 2007). This act was amended, codified in Title 11 of the US Code. It is commonly known as the "Bankruptcy Code." Ever since the codification, there have been several other amendments, with the most recent being in the year 2005, by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) (Grant, 2012, 24). There are some laws that are related to bankruptcy, which exists in other parts of the US Code. For instance, in Title 18 of the United States Code (Crimes), there are laws related to bankruptcy crimes. In Title 26 of the United States Code (also known as Internal Revenue Code), there are laws related to tax implications of bankruptcy. In Judiciary and Judicial procedure (Title 28 of the United States Code), there is the development as well as jurisdiction of bankruptcy courts (Eber, 2012).

The Bankruptcy Reform Act of 1978 has been suggested by authors such as Emerson (2009) as the major revamp of the legal system as far as bankruptcy is concerned. To begin with, it dealt with the cases that were filed after October 1, 1979. Secondly, the act had four main titles. The first (Title I) was the U.S. Code's amended Title 11. The second (Title II) included the amendments to Title 28 as well as the Federal Rules of Evidence. The third title (Title III) established the essential amendments in other federal legislation that were impacted by the changes in bankruptcy law. The last title (Title IV) offered for the pre-Code bankruptcy's repeal, as well as necessary savings provisions, the effective dates of parts of the new law, interim housekeeping details, and the United States trustee's pilot program (Grant, 2012).

Possibly, the most significant changes under the 1978 Act to bankruptcy law were in relation to the courts. The structure of the bankruptcy courts was considerably changed by the 1978 Act. The law also bestowed all-encompassing subject matter jurisdiction on these courts. "The act granted the new jurisdiction over all civil proceedings arising under title 11 or arising in or related to cases under title 11" 28 U.S.C. §1471(b) (1976 ed. Supp.). The newly established courts were the district court's denominated appendages. However, in practice, they were free-standing courts. Bankruptcy judges were given the role of exercising the expanded jurisdiction. The judges would go on being Article I judges, whose appointment was made by a set team.

Comparative Cases

In *Northern Pipeline Co. v. Marathon Pipe Line Co.*, [458 U.S. 50, 102 S. Ct. 2858, 73 L. Ed.2d 598 [6 C.B.C.2d 785]] (1982) case, the provisions of this act were subjected to major criticism (Emerson, 2009). In this case it was held unconstitutional by the court the wide-ranging provision of jurisdiction to judges given the fact that their appointment was not under as well as protected by Article III's provisions. Under the Constitution of the United States, judges appointed under Article III hold offices in an appointment for life (or during good behavior), and it is completely forbidden to decrease their pay during their life in office. Similar rights are not provided to judges appointed under Article I. The challenge related to the jurisdiction began when an adversary proceeding was filed by a creditor in bankruptcy court. The case was related to issues like warranty, breach of contract, and misrepresentation. The motion to dismiss was denied by the court to the defendant, but the defendant later filed an appeal to the District Court. It was held under the appeal that 28 U.S.C. §1471 was a violation of Article III given that it delegated powers of Article III to a non-Article III Court by granting the broad jurisdiction to the bankruptcy courts (Christopher, 2011). The judgment made by the Court stayed up to October 4, 1982 to grant "Congress opportunity to reconstitute the bankruptcy courts or to adopt other valid means of adjudication, without impairing the interim administration of the bankruptcy laws" (Allen, 2008, 63). Following the expiry of the stay, Congress still did not act. Rather, an "Emergency Rule" model was implemented by the district courts as a local rule. The rule was enacted with the aim of avoiding the collapsing of the bankruptcy system. It was also just a temporal measure of providing the organized governing of bankruptcy cases as well as proceedings following Marathon. Until the 1984 legislation was enacted the rule was still in effect. Although the legality of the “Emergency Rule” under the United States constitution was under regular criticism, the US Supreme Court time and again denied certiorari (Lewis, 2010).

Congress enacted a “permanent” legislative resolution in 1984. This was with the aim of discussing the issues that were raised in *Marathon.* The answer was in the enactment of the Bankruptcy Amendments and Federal Judgeship Act of 1984. With a small number of exceptions, by this act, like the trial of wrongful death and personal injury matters and claims that necessitate consideration of Title 11 together with activities or organizations that affect interstate business, the newly established bankruptcy courts were given the authority to exercise the district courts’ subject matter jurisdiction. This meant that the bankruptcy courts were now permitted to deal with cases like *Marathon* (Remington, 2012).

The 1984 Act, was the same as the Bankruptcy Act of 1898 in many ways. One of these ways was that the law offered for the separate units’ re-designation for bankruptcy judges. This was possible under the district courts. The cases related to bankruptcy that were pending on or filed after 1984, July 10, became subject to a number of the amendments related to bankruptcy jurisdiction. In 1986, the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, was enacted. The act established a number of major changes related to family farmers as well as creating a permanent trustee system in the country. This act would only relate to cases which were filed beginning 1986, November 26. In 1994, the Bankruptcy Reform Act of 1994 was enacted and would only be related to cases, which were filed on or after 1994, October 22. The reform act as well as the case law which interpreted its requirements had a major effect on the mortgage banking sector as well as mortgage loans servicers (Nathalie, 2008).

Bankruptcy Protection Law In The US Today

The Bankruptcy Abuse Prevention and Consumer Act of 2005, understood under the current bankruptcy system, resonate the logical foundation that supervision and litigation of the bankruptcy proceeding is done in the US Bankruptcy Courts. These courts are under the District Courts in the country. With reference to the Detroit Bankruptcy Case, it emerges that even in that diminished state, Detroit's July 18 filing for bankruptcy protection was by far the largest in U.S. history. The court fight is likely to be protracted and costly, with creditors facing steep losses and fears over potential loss of benefits for more than 9,000 workers and over 23,000 retirees (Remington, 2012). This has the implications that the establishment of The United States Trustees was done to deal with most of the supervisory as well as administrative roles related to bankruptcy proceedings. The Bankruptcy Rules are used in governing the bankruptcy courts proceedings. The Supreme Court promulgated these rules were under the power of Congress. Generally, two basic kinds of proceedings exist in the United States under the bankruptcy legal system. Under Chapter 7, there is a filing referred to as liquidation, which is generally the most common kind of bankruptcy proceeding. This entails the appointing of a trustee who is responsible for collecting the debtor’s non-exempt property, selling it and distributing the revenue from the sale to the creditors (Allen, 2008).

Under Chapters 11, 12, and 13, bankruptcy proceedings entail the debtor’s rehabilitation to enable him or her to continue with business and use the revenue to pay the creditors at a later date. Proceedings under Chapter 7, 12, 13, and a number in Chapter 11, there is appointment of a trustee who is responsible for supervising the debtor’s assets. Any bankruptcy proceeding is either initiated by a creditor, or a debtor entering into it voluntarily. Once the filing of a bankruptcy proceeding is done, for the most part, creditors, might not seek recover their debts independent of the proceedings. Subject to the proceedings, the debtor is prohibited from transferring assets, which have been declared a part of the estate. Additionally, there might be delaying or invalidation of some pre-proceeding property transfers, secured interests, as well as liens. Most of the Bankruptcy Code’s provisions also develop as priority of the interests of the creditors (Remington, 2012).

Nevertheless, some recent Supreme Court’s decisions have moved this authority toward the debtor. For example, in *Rousey v. Jacoway*, (2005), it was held by the court that property in Individual Retirement Accounts (IRA’s) were under protection under 11 U.S.C § 522(d). Thus, such assets or properly was excused from being withdrawn from the bankruptcy estate. This is one of the decisions that have major impacts for the baby-boomer generation. This is because they are offering millions of people in the country who are close to retirement greater protection for their assets and earnings (Nathalie, 2008). This case is similar to the Detroit case in respect to the fact that According to Sharon Levine of law firm Lowenstein Sandler LLP, counsel for the union American Federation of State, County and Municipal Employees (AFSCME), the union "firmly believes that a decision of this constitutional magnitude is not properly within the jurisdiction of any bankruptcy court." (Remington, 2012).

The bankruptcy Prevention and Consumer Protection Act 2005 has also led to great changes in the bankruptcy legal system. The act outlines a number of revised guidelines that should govern Chapter 7 liquidations’ conversion or dismissal to proceedings under Chapter 11 or 13. The role of the US Trustees Program has also been expanded by the 2005 Act, to incorporate random and targeted audits' supervision, entities' certification to offer credit counseling which persons must get prior to filing for bankruptcy, entities' certification which offer financial information to persons prior to a discharge from a debt, as well as a higher level of oversight of small business reorganization cases under Chapter 11 (Lewis, 2010).

The bankruptcy Prevention and Consumer Protection Act 2005 prescribes that in bankruptcy proceedings, there is a privilege offered to the debtors to retain some amount or kinds of assets or property, which otherwise would be liquidated or seized by the creditors to pay for the debts. Such laws that protect the debtor in this manner are referred to as exemptions. In line with the objective of allowing the individual debtor with "fresh start," these laws in relation to bankruptcy cases are meant to ensure that even after fulfilling his financial obligation to the creditors, the individual does not remain destitute (Christopher, 2011). The law generally allows the debtor to maintain some of the property such as house, car, and personal effects such as clothing. While this law might hinder the creditors from collecting their entire debts, it relieves the state from the responsibility of taking care of the basic needs of the debtor after paying the debt. While the bankruptcy code offers a list of uniform exemptions, it also provides for the states to *opt out of* (override) the exemptions (11 U.S.C.A. § 522 [1993 & Supp. 2003]). This means that the amounts as well as the kinds of property or assets under the exemptions vary from state to state. Most of the states in the country have decided to opt out and have thus established their own legislations in relation to this law. One of the most common exemptions is *Homestead exemption*, which allows the debtor to maintain his or her home in the process of paying for the debts. However, even this is not uniform across states in the country (Remington, 2012).

*The bankruptcy Prevention and Consumer Protection Act 2005 outlines that p*rotection of the debtor in the process of paying for the debt, while receiving some criticism, is beneficial for the overall economy of the United States. While the government should ensure that even in the event of bankruptcy the debtors are able to recover their money, it is important that in the process the law does not leave destitute Americans to depend on the state. Once the individual has filed for bankruptcy, it is sufficient that the law assesses the assets and properties of the debtor, sells it and divides the proceeds among the creditors to recover their money. However, in the process, the law should protect American debtors by providing them with the means to continue living a comfortable life. This is possible through the exemption law (Lewis, 2010).

While *The bankruptcy Prevention and Consumer Protection Act 2005* looks effective in protecting the interests of both the debtors and creditors in the event of a bankruptcy, it has not been without a share of criticism. Generally, it is agreed that regardless of whether the case is filed by the debtor voluntarily or by the creditor, such cases tend to be complex in nature (Christopher, 2011). Additionally, the nature of the complexity of these cases can increase when dealing with organizational bankruptcy, and bankruptcy pertaining cross-border entities. It is evident from the entire discussion that the straightforward nature of the bankruptcy cases is in relation to when dealing with individual debtors, as it is easy to assess and quantify their assets and property, sell it and use the proceeds to pay the creditors. On the other hand, when dealing with huge organizations and companies, as well as with cross-border entities, it becomes a challenge to apply the Bankruptcy protection laws as they are. For example, it might be a challenge to establish what the organization owns independent of its owners and other stakeholders. Additionally, for cross-border entities, it is a challenge to assess all the assets and propertied owned by the entity, especially those outside the country (Grant, 2012).

With the increase in globalization, individuals and organizations are moving their operations in other parts of the world, making the bankruptcy cases even more complicated. With such changes in the business environment, it calls for changes in the bankruptcy protection law to be able to effectively cater for the interests of the debtors and the creditors in the event of filing for bankruptcy. There is need to address the various ambiguities inherent in the bankruptcy protection law in the United States to make it more reliable and effective. This should come in form of more amendments or complete overhaul of the bankruptcy protection system. One of the ways this can be achieved is bringing together under one article the various parts of bankruptcy protection distributed in different articles in the Constitution. The USA bankruptcy protection laws deal with inter alia issues of estate, avoidance action, automatic stay, fraudulent transfer, preference, non-bankruptcy law creditor, executive contracts, redemption, debtor's discharge, entities that cannot be bankrupt, and exempt. This needs to change to make the protection more effective and the law more applicable to diverse cases related to bankruptcy, whether involving individuals or organizations, nationally or internationally (Allen, 2008).

Conclusion

Bankruptcy protection law in the United States has a long history dating back to the English law, which was more punitive towards the debtors, that protective. However, due to the dynamic nature of the law, major changes and amendments have been made over the years, which have led to a system that is more protective towards the debtors than punitive. However, while the law is effective in protecting individual debtors, there are still major ambiguities in its translation and application that should be addressed to make it more reliable and effective. Major amendments or even complete overall of the bankruptcy protection legal system is necessary to ensure this is done. The research paper recommends more research towards the changes that can be implemented.

Acknowledgment

In completion of my dissertation, I feel it is important to acknowledge God and others for their support on this extended journey. To begin, Allah "God," without his help, I would not be here or be able to complete this dissertation. I also give my highest thanks and appreciation to Professor Joseph J. Norton for the extensive feedback he gave me throughout the completion of this dissertation.

References

[1] Allen, S. C. (2008). *Bankruptcy Law.* New York: InfoBase Publishing.
[2] Cambridge University Press. (2011). *Cambridge Business English Dictionary.* New York: Cambridge University Press.
[3] Christopher, M. S. W. (2011). *The Law and Practice of Restructuring in the UK and US*. New York: Oxford University Press.
[4] Eber, A. (2012). *Asset Protection Strategies and Forms.* California: James Publishing.
[5] Emerson, R. (2009). *Business Law.* New York: Barron's Educational Series.
[6] Frey, M. (2007). *Introduction to Bankruptcy Law,* 5th Ed. New York: Cengage Learning.
[7] Grant N. R. L. (2012). *Bankruptcy and Insolvency Taxation*. New York: John Wiley & Sons.
[8] Lewis S. L. S. (2010). *Asset Protection Strategies 2009.* chicago: CCH.
[9] Nathalie M. O. T. (2008). *Inside Bankruptcy Law: What Matters and why*. New York: Aspen Publishers Online.
[10] Remington, H. (2012). *A Treatise on the Bankruptcy Law of the United States*. New York: General Books LLC.

Saud Alharthi, received the B.A. from the Islamic University of Madinah in 2009 and L.L.M. degrees, from Southern Methodist University School of Law in 2013. He received the S.J.D from Case Western Reserve University School of Law in 2018. He is working as an assistant professore at Umm Al-Qura University, school of law. His research interest includes commercial law.