Pending bankruptcy bill ill-advised

By Leonard G. Green

Point of view

(Editor's Note: The writer is an attorney who practices in Smithfield and has considerable experience in handling bankruptcy cases.)

Legislation pending in the N.C. General Assembly would deny North Carolina residents the exemption provisions of the Bankruptcy Act. Such legislation, if adopted, would have profound effect on consumers who are confronted with the unfortunate possibility of bankruptcy.

The first American Bankruptcy Act was enacted by Congress in 1800. Derived from English law, it was designed to give creditors a means of liquidating an insolvent business. The act was subsequently rewritten to include relief for individuals who are overwhelmed by their debts. The relief is in the form of a release from debts, except for certain non-dischargeable debts such as child support, taxes and most student loans.

The Bankruptcy Act is founded upon the sound public policy that people who are hopelessly insolvent should not be doomed to permanent poverty. Rather, there should be some remedy by which such people can rehabilitate their financial condition, and again become solvent participants in our economic system. Without the alternative of bankruptcy, such persons and their families would be devastated by repossessions and lawsuits, and left destitute as charges upon society.

Thus, the Bankruptcy Act serves a necessary and legitimate role in our economic and legal systems. Sincere, hard-working people can become overwhelmed by their debts as a result of causes beyond their control. For instance, payments may be missed because of unemployment or a long-term illness. This causes creditors to become anxious, and may lead to threats of repossession and legal action. The debtor must do something to try and save the family furniture or car.

The problem may be temporarily resolved by refinancing the debts. However, this is costly. Repeated refinancing can result in payments of large amounts of interest, frequently more than the original debt. This refinancing treadmill merely places the person further and further in debt. Debtors may see their entire payment go to interest with no reduction in the principle. At this point, bankruptcy may be the only real alternative for the person.

Financial rehabilitation can be achieved only if the person has something left with which to begin anew after the bankruptcy. This is the role of the Bankruptcy Act exemptions. These provisions exempt certain property from being sold by the Bankruptcy Court. However, no property is exempt unless its purchase price has been fully paid. This means that creditors who sold and financed the purchase of the property get their property back, or the person must reaffirm and pay the debt, regardless of the bankruptcy. This rule applies to all property being purchased by installment payments. Debtors are not allowed to retain such items as cars or televisions unless they continue paying the creditor the purchase price. The Bankruptcy Act exemptions do not apply to such property.

If the purchase price has been fully paid, the person is allowed to keep certain property that is necessary for a fresh start. Such necessities include furniture (but no item over $200 in value), a car (not over $1,200 in value), equity in a house (up to $7,500), tools and health aids. Thus, even where the purchase price has been paid, no item is exempt unless its value is below these reasonable levels. These restrictions provide a fair balance between the creditors' interests and the debtor's need for subsistence.

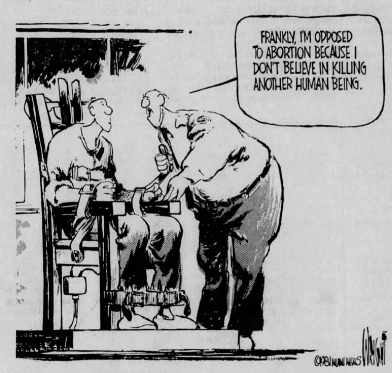
Prior to 1979, the Bankruptcy Act did not contain any exemption provisions. The exemptions allowed were those existing under state law where the bankruptcy case was filed. This resulted in great disparities among the states as to what items a person was allowed to retain. The Bankruptcy Act exemptions were designed to eliminate this inequit. However, the act allows states to opt out of these uniform exemptions, and again apply their local provisions.

If the General Assembly denies North Carolina residents the reasonable exemptions of the Bankruptcy Act, then our state will revert back to its severely outdated personal property exemptions. Under these exemptions, a debtor can keep only up to $500 in personal property and $1,000 in equity in a house. In effect, this means no one can save a house and only a few items of personal property are spared. These are the same levels that were adopted in the North Carolina Constitution of 1868. They are obviously inadequate. In fact, if these provisions were updated to reflect 1981 property values and prices, they would surely equal or exceed the present Bankruptcy Act exemptions.

The number of personal bankruptcies has increased recently. Some people have asserted that this is due to the improved exemptions. However, it is more likely that it has been caused by high unemployment, inflation and an increase in the general public's awareness of legal remedies such as bankruptcy.

Along with the rise in the number of bankruptcies has come the inevitable allegations of abuse of the procedure. Some creditors contend that some people are borrowing money to "live it up," with the intention of later filing for bankruptcy. In fact, such instances are extremely rare. Furthermore, the Bankruptcy Act provides creditors with a means of denying a person's discharge if the person had contracted debts through misrepresentation or fraud. Courts have held that contracting debts with the intent to file subsequently for bankruptcy renders such debts non-dischargeable.

The Bankruptcy Act provides a necessary remedy for those persons who are hopelessly overwhelmed by their debts. The act's exemption provisions are a crucial component of this remedy. These provisions should be retained in North Carolina. At the very least, a revocation of the Bankruptcy Act exemptions should be accompanied by a substantial increase in North Carolina's exemption provisions.



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