

**THE WHITE HOUSE**

WASHINGTON

May 5, 2000

**MEMORANDUM FOR THE PRESIDENT**

**CC: JOHN PODESTA**

**FROM: GENE B. SPERLING**  
**SARAH ROSEN WARTELL**

**RE: BANKRUPTCY LEGISLATION**

**ISSUE PRESENTED:**

The NEC Bankruptcy Working Group has prepared a letter to the Congress setting forth our detailed views on the House and Senate bankruptcy reform bills. Both of these bills passed by overwhelming margins, despite our threat to veto the House bill and the important reservations we expressed about the Senate bill. Consumer groups continue to oppose these bills. Many major editorial pages have been critical of both bills, although most are more favorable toward the Senate bill. We expect some will oppose the final product. The letter to Congress would reiterate our previous statements: It again threatens to veto the House bill and says that the Senate bill better meets your principles, although we have some serious concerns. Despite the lengthy criticism of the bills' provisions, the letter effectively signals that you are likely to sign the final legislation unless it contains the most noxious House provisions or drops most of the consumer and debtor protections achieved by Senate Democrats. We seek your reaction to this strategy before the letter is sent.

**VIEWS OF YOUR ADVISORS:**

- All of your advisors support balanced bankruptcy reform. All believe that the final bill will do some good by encouraging personal responsibility and lowering credit card interest rates that are inflated because some debtors are too ready to use and even abuse Chapter 7's bankruptcy discharge. All of your advisors also agree that, due to an expensive lobbying effort by the credit card industry, the final bill will lack the balance we sought and will not demand similar responsibility from the credit card industry.

An important issue is whether or not the new rules, determining who should be required to go

into Chapter 13 (which requires repayment of what a formula says you can repay), are flexible enough to deal with specific cases of hardship in unusual circumstances. The provisions we have pushed for - ultimately allowing the bankruptcy trustees and courts greater discretion - have been largely rejected. We have made reasonable progress in the bill in other areas; for example, the bill protects child support and alimony from competition from credit card debt in many cases and includes a safe harbor from the means test for below-median-income debtors.

Assuming that the final bill that comes to your desk is close to the Senate bill, all of your advisors agree that you should sign it, although for somewhat different reasons. Jack Lew, Chuck Brain, and Gene Sperling believe that, while the final bill may be on the whole a net minus, it is a relatively close call, and not worth the political downside of a veto override. Larry Summers believes that a final bill relatively close to the Senate bill is a net plus and should be signed on the merits. Bankruptcy reform, Larry argues, will have an impact similar to that of open trade: a few visible cases of hardship, but a larger less visible benefit of lower interest rates for credit card borrowers.

All of us feel that, while it is unfortunate that we do not have a more balanced bill, if the final bill stays relatively close to the Senate bill, it would be better to sign the bill with some reservations than to risk a veto override. For you to have any chance of sustaining a veto, or even to make a strong public statement through an override, we would need to launch a high, profile battle against a “paid-for” bankruptcy bill - a battle that would indirectly put us at odds with friends like Senators Daschle and Torricelli, and allow others to say we were walking away from our individual responsibility message.

## **BACKGROUND:**

Last May, the House bill passed by a veto-proof margin of 313 to 108. A Democratic substitute that we crafted with Congressman Nadler received only 149 votes and had no effect on our effort to give enough Democrats cover to help us achieve a veto-sustaining margin. Key House Democratic leaders, including Representatives Martin Frost, Bob Menendez, and Patrick Kennedy supported the underlying bill and opposed the Nadler substitute. Minority Leader Gephardt opposed the bill, although he announced his position well after other Members’ positions in support had settled. When we talked to Senate Democrats, we found few were interested in our substantive concerns and many were eager to see a reform bill enacted. Some were willing to press for changes and modest improvements were achieved as a result. But few Senate Democrats were willing to oppose the legislation despite its imbalances. As a result, an improved but flawed bill passed the Senate by a vote of 83-14. Democrats opposing the bill on bankruptcy grounds were Senators Kennedy, Wellstone, Dodd, Feingold, Harkin, Reed, Sarbanes, Schumer, Lautenberg, and Moynihan. (A few of the 14 opposed the bill for other reasons.)

Although a formal conference committee has not been named, Congress is now working to reconcile the House and Senate bills. Republican and Democratic leadership expect to attach the bankruptcy provisions to a conference report on other legislation (perhaps Digital Signatures or Crop Insurance) in order to avoid procedural roadblocks placed by Senators Wellstone and

Kennedy in trying to force another Senate vote on a two-year minimum wage increase.

The NEC working group drafted a letter to the informal conferees setting forth the Administration's detailed views on various provisions of both bills. It reiterates your senior advisors' veto threat that we issued on the House version of the legislation last May. It describes the Senate bill as more balanced and doing a better job of meeting your principles, although it details serious concerns we have about some of the Senate bill's provisions.

In a few cases, the letter explains that the House language is actually better than the Senate approach. (The letter also reiterates the veto threat on a bill including the minimum wage, tax, and school voucher amendments that were attached to the bill by the Senate, but we expect those non-relevant provisions to be dropped.) (Copy of cover letter at Appendix A.)

Your senior advisors believe that the relatively muted tone of this letter signals that you are likely to sign the final legislation, albeit with reservations. The details in the letter provide helpful guidance to the Democratic negotiators attempting to improve the bill in conference. Unless we significantly raise the level of our rhetoric now, your advisors will likely recommend that you sign the final bill, unless it drops the most visible improvement achieved by Senate Democrats or includes the most noxious aspects of the House bill.

Appendix B is a more detailed summary of some of our substantive concerns with the House and Senate Bills.

**DECISION:**

*Proceed with Letter* \_\_\_\_\_ 3

*Let's Discuss* \_\_\_\_\_

[Date]

The Honorable Orrin G. Hatch  
Chairman  
Committee on the Judiciary  
United States Senate  
Washington, D.C. 20510

Dear Chairman Hatch:

The Administration understands that, although conferees have not yet been named, your staff are discussing ways to reconcile the House and Senate versions of H.R. 833, the Bankruptcy Reform Act. The attachment to this letter outlines the Administration's views on these two versions of the bill. As you and your staff develop an agreement on this bill, your consideration of these views would be appreciated.

The President supports balanced consumer bankruptcy reform that would encourage responsibility and reduce abuses of the bankruptcy system on the part of debtors and creditors alike. To meet the test of balance, the bill that emerges from conference should be consistent with the key principles set forth by the President, as described in the enclosure. The President was disappointed that the House once again failed to produce balanced bankruptcy legislation that he could support. As we stated when H.R. 833 came to the House floor last spring, the President's senior advisors would recommend that he veto the House bill if it were presented to him. The bankruptcy provisions of the Senate bill generally do a better job of meeting the President's principles, although the Administration has serious concerns about some provisions.

The Administration notes that certain non-relevant amendments have been included in the Senate version of the bill. The President has made clear on a number of occasions that he strongly supports an increase in the minimum wage of \$1 over the next two years. However, as the Administration has stated previously, if Congress sends him a bill delaying the increase, repealing overtime protections for certain workers, adding costly and unnecessary tax cuts that threaten fiscal discipline and direct benefits away from working families, thwarting ongoing efforts to enforce pension law, and including an objectionable private school voucher provision, he will veto it.

Thank you for your consideration of the Administration's views on these bills. We would be happy to discuss any of these concerns with you or your staff.

Sincerely,

Jacob J. Lew

Enclosure

Identical letters sent to The Honorable Patrick J. Leahy,  
The Honorable Henry J. Hyde, and The Honorable John Conyers, Jr.

**SUBSTANTIVE CONCERNS WITH THE HOUSE AND SENATE BILLS**

**Homestead Exemption:** The Senate bill includes a \$100,000 cap on the amount of home equity that states can allow debtors to shield from their creditors. The House bill has a cap of \$250,000, but allows a state to opt-out, effectively eviscerating the cap. We have argued that it is fundamentally unfair to ask moderate-income debtors to repay what they can, while wealthy debtors can shield their resources in expensive homes. Most expect that the Senate cap will be dropped in conference, although rhetoric on this issue has the greatest potential to embarrass bill proponents.

**Credit Card Protections:** Although the provisions in both bills are weak, the Senate is somewhat stronger, providing new disclosures on teaser rates and the impact of making only the minimum payment on the length of time one will be repaying debt. Senate Democrats, including the leading Democratic bill proponent Senator Torrecelli, say they will oppose a conference report that further weakens these provisions, so the Senate provisions are likely to survive intact.

**Means Test for Chapter 7 Discharge:** Both bills use IRS tax collection guidelines to establish tests to determine whether a debtor has the capacity to repay a portion of their debt under a Chapter 13 repayment plan. If so, filing for a Chapter 7 discharge is deemed abuse. The House test is very rigid; the Senate bill has a bit more flexibility. 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 (like the IRS has when it used the guidelines for tax collection). We also sought less stringent thresholds and various technical changes to prevent unfairness in the application of the test. Some provisions from each bill are better, but neither bill would address our fundamental concern. We expect a compromise with some of the better and worse features of each.

**Protection of Child Support and Alimony:** In the last Congress, the First Lady wrote of her concern with provisions that made 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 added numerous provisions to clarify that child support and alimony are the highest priority. We believe that 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, where there is no court supervision of child support and alimony payments or wage garnishment, these credit card debts could crowd out child support or alimony. Our argument is very technical; rhetorically, they have neutralized our criticism.

**Debtor Protections Against Coercion:** During bankruptcy, too many debtors are misled or tricked into agreeing to repay debts that they cannot afford and have a legal right to discharge. The Senate bill contains provisions that make it significantly more difficult to mislead or deceive debtors who cannot afford to reaffirm their debts, although the provisions could be significantly improved to strengthen the hand of debtors seeking remedies when the bill's requirements are not observed. (Certain consumer groups actually oppose the stronger Senate provisions, even

though they would prevent many more abusive reaffirmations, because they also may provide creditors with new legal arguments in defending litigation.)

The House bill has far weaker provisions and, most notably, a ban on class actions when seeking remedy for abuse of these requirements. We expect the class action ban to be dropped and the Senate provisions to be retained largely intact, but without the desired improvements. If the class action ban is retained, newfound opposition to the bill may arise.

**Clinic Violence:** Recently, anti-abortion protesters have used personal bankruptcy to avoid penalties for violence against family planning clinics, some even strategically sending protestors who are judgment proof. Senator Schumer offered an amendment in the Senate that would make court-ordered and other debts resulting from such violence nondischargeable. We strongly supported the amendment. The Vice President was present in the Senate Chamber when they voted on the amendment to break a tie, if needed. To avoid embarrassment, Republicans urged their members to vote for the amendment and it passed by a vote of 80-17. The House has no comparable provision. In conference, they are expected to modify the amendment so that it covers debts from acts of violence generally, so they can avoid special protection for clinic violence debts. There may be technical flaws in their drafting of the broader amendment, so it will not protect all clinic-related debts. Abortion rights groups are not sure whether they want to fix these flaws, preferring to have the issue. If the Republicans drop the provision, Senate Democrats will likely rally; but if they simply broaden it to cover other violence, those eager to vote for the bill will likely concur.

**Pension Benefit Protections:** The Senate bill also included a provision that would allow debtors to waive in advance bankruptcy protections for certain retirement assets (IRAs and non-ERISA plans). Senator Grassley had earlier offered a provision that would have capped the pension assets that debtors could shield from creditors in bankruptcy, but facing labor opposition to that he instead opted for this. We fear that those of limited means and sophistication could be compelled (perhaps in the boilerplate of a credit card or loan application) to waive protections for the retirement assets. As awareness of this provision has grown, it has provoked a firestorm. We expect it to be modified or eliminated.