

WILL THE MEDICAL BANKRUPTCY FAIRNESS ACT OFFER A CURE FOR DISTRESSED MEDICAL DEBTORS?

By Nancy Simons and Nikki Farris¹

I. Introduction

It is estimated that approximately two-thirds of consumer bankruptcies are caused by medical issues whether they are triggered by the unexpected high costs of medical care, or the cost of missing work and wages.² The COVID-19 pandemic increased the risk for many Americans of filing bankruptcy due to medical issues, given the loss of health insurance caused by rising rates of unemployment.

Over the past decade, legislators have attempted to address the challenges facing Americans who are unable to pay their medical bills. The Medical Bankruptcy Fairness Act of 2021 was introduced in the Senate earlier this year as a reiteration of earlier legislation proposed to help streamline bankruptcy procedures for medically distressed debtors whose financial issues resulted from medical debt or public health closures. It was referred to the Judiciary Committee—where it awaits further action.

This article provides an overview of the pending legislation, a history of previous legislative attempts to provide relief to medically distressed debtors, the potential impact the legislation would have on distressed medical debtors, and the bankruptcy process and filing trends if passed.

II. Background on Medical Bankruptcies

Medical debt continues to be one of the leading causes of consumer bankruptcy filings in the United States according to bankruptcy experts. Recent studies show that more than 14 million Americans lost health insurance coverage during the COVID-19 pandemic due to loss of employment coupled with

¹ Nancy Simons is Regional Director at Stretto and Nikki Farris is principal of the Law Offices of Nikki Farris.

² David U. Himmelstein, Robert M. Lawless, Deborah Thorne, Pamela Foohey, Steffie Woolhandler, *Medical Bankruptcy: Still Common Despite the Affordable Care Act*, AM. J. PUBLIC HEALTH 109, no. 3, Mar. 1, 2019: 431-43, <https://ajph.aphapublications.org/doi/10.2105/AJPH.2018.304901?eType=EmailBlastContent&eId=a5697b7e-8ffc-4373-b9d2-3eb745d9debb&=&>.

contracting the virus.³ As stimulus funds and forbearances expire as the country emerges from the COVID-19 pandemic, many experts are forecasting a surge of personal bankruptcies particularly for those who were impacted by medical issues or loss of employment as a result of the COVID-19 public health crisis.

The current bankruptcy system does not take into account the cause that led the debtor to file bankruptcy, whether it be a medical crisis or other financial difficulties. Beyond the hard financial costs involved in medical crises, these costs can trigger a domino effect that impacts every aspect of the debtor's personal and professional life, including their ability to function in their job, their physical and mental well-being as well as their family and social life.

In addition, medical debt is usually involuntary and can accumulate at an exponential rate beyond the ability of the individual to pay based on today's elevated healthcare costs, even for those with health insurance. As a result, many feel that medical debt should be treated differently than other types of debt in bankruptcy.

Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), specific provisions were put in place to curb the abuse of bankruptcy, which also have made it more challenging for medically distressed debtors to discharge their medical debt. By establishing a means test, debtors with higher incomes and assets, but unable to pay their medical debt became limited in their ability to gain a fresh start following a medical crisis. These developments created new obstacles for those with legitimate needs to resolving their debt obligations through bankruptcy.

III. Overview of the Medical Bankruptcy Fairness Act

Co-sponsored by U.S. Senators Tammy Baldwin (D-WI), Sheldon Whitehouse (D-RI), Sherrod Brown (D-OH), Elizabeth Warren (D-MA), and Richard Blumenthal (D-CT), the Medical Bankruptcy Fairness Act (the "Act") was introduced to address the potential for a wave of consumer bankruptcies due to the financial distress that families and individuals have faced during the COVID-19 crisis.

³ Paul Fronstin & Stephen A. Woodbury, *How Many Americans Have Lost Jobs with Employer Health Coverage During the Pandemic?* COMMONWEALTH FUND (Oct. 2020), <https://doi.org/10.26099/q9p1-tz63>.

The Act proposes to implement a more debtor-friendly process for those who need to file bankruptcy as a result of losing their job or racking up massive medical debt from a health crisis. It would eliminate procedural burdens such as the requirement for credit counseling which is usually not relevant in situations where debtors were forced into bankruptcy due to medical debt. In addition, the Act would allow for the discharge of student loans for those who have filed due to medical reasons. It would also improve the chances for families who live in states with lower exemptions to keep their homes by permitting the retention of a minimum of \$250,000 of home equity.⁴

The Act is not the first to attempt to address the issue of medical debt-induced bankruptcies. Previous versions of the bill were introduced to Congress as S. 1624 — The Medical Bankruptcy Fairness Act of 2009; H.R. 4917 — The Medical Bankruptcy Fairness Act of 2014; S. 3385 — The Medical Bankruptcy Fairness Act of 2016; and S. 4305 — The Medical Bankruptcy Fairness Act of 2020. These bills did not progress due to lack of consensus on both sides of the issues they set out to address.

As the economic picture has worsened over the past year with the COVID-19 pandemic and economic crisis, supporters of the Act hope it will gain more traction this year as a greater number of individuals have been impacted directly or indirectly in either losing employment or facing a massive medical debt as a result of the pandemic.

A. Definition of a Medically Distressed Debtor

The Act is similar in many ways to prior legislation however, it differs from its predecessors in that it expands the definition of a medically distressed debtor to allow for student loan discharge within bankruptcy even for those who have not incurred medical debt but have experienced a change in employment during the pandemic that lowered their income.⁵

Previous legislation set out to create a category of consumer debtors as “medically distressed debtors” which included any individual who accumulated medical debt that was more than 10% of their adjusted gross income during the

⁴ Medical Bankruptcy Fairness Act of 2021, S. 146, 117th Cong.

⁵ *Senate Bill Would Discharge Substantial Student Loan Debt to Medically Distressed*, CHAMBLISS (Mar. 2, 2021), <https://www.chamblisslaw.com/senate-bill-would-discharge-substantial-student-loan-debt-to-medically-distressed/> (last visited June 7, 2021) [hereinafter “*Chambliss*”].

three-year period prior to filing bankruptcy.⁶ Under previous bills, once the debtor would be designated as a medically distressed debtor, they would be eligible for protections that enabled them to retain their residential equity, waive credit counseling and discharge student loans without the requirement of proving undue hardship.⁷

The Act goes a step further than previous legislation by creating a new criterion that broadens the definition of who can qualify as a medically distressed debtor even if they have not incurred medical-related debt.⁸ It would enable anyone who had a change in employment status that reduced their salaries, wages, commissions or work hours or who lost their jobs due to the COVID-19 pandemic to be designated as a medically distressed debtor. While prior legislation required medical debt to be incurred, the current proposed Act only requires a reduction of any size in the individual's income or employment status.⁹

Under the broadened definition of a medically distressed debtor, it is expected that many will seek the benefit of the Act's amendment to 11 U.S.C. § 523(a)(8),¹⁰ which would authorize qualified debtors to discharge student loan debt without proving an undue hardship or inability to repay the loan.

Currently, bankruptcy debtors cannot have their student loan debt discharged unless they demonstrate undue hardship.¹¹ In addition, they are required to initiate an adversary proceeding to prove they meet the undue hardship standard.¹² At the same time, the lender is permitted to present evidence that the debtor has not met the standard which adds to the debtor's challenge to show they qualify.

These changes would be temporary as they only would benefit debtors who are working during the pandemic and would require those who are seeking to

⁶ S. 146, 117th Cong. (2021).

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Chambliss, supra* note 5.

¹¹ *See* 11 U.S.C. § 523(a)(8); *In re Koeut*, 622 B.R. 72 (Bankr. S.D. Cal. 2020).

¹² FED. R. BANKR. P. 7001(6).

discharge student loan debt to file for bankruptcy within three years of the national emergency established due to the COVID-19 pandemic.^{13, 14}

IV. Proponents vs. Opponents of the Medical Bankruptcy Fairness Act

Within the legal and political community and beyond, there are differing viewpoints concerning the Act. Proponents of the legislation point to the failures of the U.S. employment-based health insurance system as being inadequate for the needs of struggling consumers, particularly during a pandemic. Those who lose their jobs also lose their health insurance along with income, placing them at a greater risk of incurring massive medical bills in a health emergency caused by COVID or other illness.¹⁵

Opponents of the legislation argue that the bankruptcy system is not the place to address the financial impact of medical debt and that instead the healthcare system should be reformed to address the issue of skyrocketing healthcare costs and inadequate health insurance, including insurance company denials and collection efforts. They feel that the bankruptcy courts will not be able to address the underlying problems that are causing people to incur medical debt and undergo bankruptcy.¹⁶

In addition, critics of the legislation and previous bills have called into question the data showing that medical debt leads to bankruptcy.¹⁷ They suggest that medical debt and expenses lead to fewer bankruptcies than commonly believed and claimed.¹⁸

¹³ *Chambliss, supra* note 5.

¹⁴ 11 U.S.C. § 554(c).

¹⁵ *Whitehouse & Colleagues Introduce Medical Bankruptcy Bill Amid Raging Pandemic*, SHELDON WHITEHOUSE UNITED STATES SENATOR FOR RHODE ISLAND (Feb. 2, 2021), <https://www.whitehouse.senate.gov/news/release/whitehouse-and-colleagues-introduce-medical-bankruptcy-bill-amid-raging-pandemic> (last visited June 7, 2021).

¹⁶ *Medical Debt: Is Our Health Care System Bankrupting Americans?*, CAP ACTION (July 28, 2009), <https://www.americanprogressaction.org/issues/healthcare/reports/2009/07/28/6360/medical-debt-is-our-health-care-system-bankrupting-americans/> (last visited June 7, 2021).

¹⁷ Carlos Dobkin et al., *Myth and Measurement — The Case of Medical Bankruptcies*, THE NEW ENGLAND JOURNAL OF MEDICINE, Mar. 22, 2018, 1077-78, <http://economics.mit.edu/files/14892>.

¹⁸ *Id.*

Still, others oppose the legislation based on concerns that the benefits the Act offers to medically distressed debtors will be abused by those who are seeking to discharge non-medical debt. By broadening the definition of a medically distressed debtor to encompass those who may have not even suffered from a medical debt crisis, some feel that the needs of those who truly have been overlooked and not given the special consideration they may need for their unique predicaments.

V. The Potential Impact of the Medical Bankruptcy Fairness Act

While it remains unclear whether the Act will pass, some believe it will have a better chance of being passed and if nothing else gain more attention than previous legislation with the Democratic party holding majorities in both the House and Senate.

If passed, legal professionals expect that the Act will result in a significant increase in consumer bankruptcy filings with the added pressure to file within the designated window of opportunity provided by the legislation.¹⁹ While many believe it could temporarily alleviate the issues surrounding student loan debt, it does not address the underlying cause of the student loan debt crisis from a long-term perspective. The Act also does not provide assistance to those who were in school when the pandemic started.

Some foresee an increase in litigation over who is and who isn't a medically distressed debtor potentially resulting from the legislation if it is passed. In broadening the definition and qualifications for a medical distressed debtor, the Act could also open the door to individuals to take advantage of and abuse the system rather than reserving it for those who need it most.

For bankruptcy trustees, the legislation could lead to fewer cases with assets to administer as the legislation would increase the home equity exemption to the \$250,000 minimum. While the exemption is intended to help the debtor, it will limit the assets available for the estate in order to repay creditors who may be rightfully entitled to have their debt repaid.

Within California, it is important to note that the homestead exemption rate is \$300,000 if the median sale price for homes in the debtor's county were less than that during the prior year. However, it can be as high as \$600,000 if the median sale price in the debtor's county was equal to or more than that (as of January 1,

¹⁹ *Chambliss, supra* note 5.

2021), making it even more challenging for trustees to recover value in order to repay creditors.²⁰

VI. Conclusion

Medical debt creates repercussions in all aspects of a debtor's life and its causes cannot be controlled or managed unlike many other financial events leading to bankruptcy. There are no easy answers regarding how best to address the unique challenges faced by medically distressed debtors within the bankruptcy system. In context of a global pandemic and the added financial and medical burdens it created, the Medical Bankruptcy Fairness Act of 2021 brings these issues to the forefront where elected official and legal professionals can seek ways to provide a more streamlined pathway through the bankruptcy process for those who have suffered a medical crisis. Time will tell if it will lead to a cure for the financial distress afflicting medically distressed debtors in the wake of the pandemic and beyond.

²⁰ CAL. CIV. PROC. CODE § 704.730.