SPEAKERS CONTENTS INSERTS Tables

Page 1 TOP OF DOC

63–593

2000

BANKRUPTCY REFORM ACT OF 1999 (PART II)

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

ON
H.R. 833

MARCH 17, 1999

Page 2 PREV PAGE TOP OF DOC

Serial No. 10

Printed for the use of the Committee on the Judiciary

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402

COMMITTEE ON THE JUDICIARY
HENRY J. HYDE, Illinois, *Chairman*
F. JAMES SENSENBRENNER, Jr., Wisconsin
BILL McCOLLUM, Florida
GEORGE W. GEKAS, Pennsylvania
HOWARD COBLE, North Carolina
LAMAR S. SMITH, Texas
ELTON GALLEGLY, California
CHARLES T. CANADY, Florida
BOB GOODLATTE, Virginia
ED BRYANT, Tennessee
STEVE CHABOT, Ohio
BOB BARR, Georgia
WILLIAM L. JENKINS, Tennessee
ASA HUTCHINSON, Arkansas

EDWARD A. PEASE, Indiana
CHRIS CANNON, Utah

Page 3 PREV PAGE TOP OF DOC

JAMES E. ROGAN, California
LINDSEY O. GRAHAM, South Carolina
MARY BONO, California
SPENCER BACHUS, Alabama
JOE SCARBOROUGH, Florida

JOHN CONYERS, Jr., Michigan
BARNEY FRANK, Massachusetts
HOWARD L. BERMAN, California
RICK BOUCHER, Virginia
JERROLD NADLER, New York
ROBERT C. SCOTT, Virginia
MELVIN L. WATT, North Carolina
ZOE LOFGREN, California
SHEILA JACKSON LEE, Texas
MAXINE WATERS, California
MARTIN T. MEEHAN, Massachusetts
WILLIAM D. DELAHUNT, Massachusetts
ROBERT WEXLER, Florida
STEVEN R. ROTHMAN, New Jersey
TAMMY BALDWIN, Wisconsin
ANTHONY D. WEINER, New York

THOMAS E. MOONEY, SR., *General Counsel-Chief of Staff*
JULIAN EPSTEIN, *Minority Chief Counsel and Staff Director*

Page 4 PREV PAGE TOP OF DOC

Subcommittee on Commercial and Administrative Law
GEORGE W. GEKAS, Pennsylvania, *Chairman*
ED BRYANT, Tennessee
LINDSEY O. GRAHAM, South Carolina
STEVE CHABOT, Ohio
ASA HUTCHINSON, Arkansas
SPENCER BACHUS, Alabama

JERROLD NADLER, New York
TAMMY BALDWIN, Wisconsin
MELVIN L. WATT, North Carolina
ANTHONY D. WEINER, New York
WILLIAM D. DELAHUNT, Massachusetts

RAYMOND V. SMIETANKA, *Chief Counsel*
SUSAN JENSEN-CONKLIN, *Counsel*
JAMES W. HARPER, *Counsel*

C O N T E N T S

HEARING DATE

March 17, 1999

OPENING STATEMENT

Page 5 PREV PAGE TOP OF DOC

Gekas, Hon. George W., a Representative in Congress from the State of Pennsylvania, and chairman, Subcommittee on Commercial and Administrative Law

WITNESSES

Brown, William, United States Bankruptcy Judge, Western District of Tennessee, Nashville, TN, on behalf of the American Bankruptcy Institute

Carper, Thomas R., Governor of the State of Delaware, on behalf of the National Governors' Association

Culhane, Marianne B., Professor, Creighton University School of Law, Omaha, NE

Hildebrand, Henry E., III, Esquire, Chapter 13 Trustee, Nashville, TN, on behalf of the National Association of Chapter 13 Trustees

Klee, Kenneth, Professor, University of California-Los Angeles School of Law, Los Angeles, CA, on behalf of the National Bankruptcy Conference

Moore, Michael, Badcock Home Furnishing Centers, Gainesville and Cornelia, GA, on behalf of the National Retail Federation

Neubig, Thomas S., Ernst & Young LLP, Washington, DC

Page 6 PREV PAGE TOP OF DOC

Newsome, Randall J., United States Bankruptcy Judge, Northern District of California, Oakland, CA, on behalf of the National Conference of Bankruptcy Judges

Ryu, Lisa H., Staff Economist, the National Association of Federal Credit Unions, Washington, DC

Sigmon, Wayne, Esquire, Gray, Layton, Kersh, Solomon, Sigmon, Furr and Smith, PA, Gastonia, NC, on behalf of the National Association of Consumer Bankruptcy Attorneys

Stana, Richard M., Associate Director, Administration of Justice Issues, General Government Division, General Accounting Office, Washington, DC

Staten, Michael E., Professor and Director, Credit Research Center, McDonough School of Business, Georgetown University, Washington, DC

Tassey, Jeffrey A., Senior Vice President of Governmental and Legal Affairs, American Financial Services Association, Washington, DC

Waldschmidt, Robert, Esquire, Chapter 7 Trustee, Nashville, TN, on behalf of the National Association of Bankruptcy Trustees

Wallace, George J., Esquire, Eckert, Seamans, Cherin & Mellott, LLC, Washington, DC, on behalf of the Consumer Bankruptcy Reform Coalition

Page 7 PREV PAGE TOP OF DOC

Zywicki, Todd, Professor, George Mason University School of Law, Arlington, VA

LETTERS, STATEMENTS, ETC., SUBMITTED FOR THE HEARING

Brown, William, United States Bankruptcy Judge, Western District of Tennessee, Nashville, TN, on behalf of the American Bankruptcy Institute: Prepared statement

Carper, Thomas R., Governor of the State of Delaware, on behalf of the National Governors' Association: Prepared statement

Culhane, Marianne B., Professor, Creighton University School of Law, Omaha, NE: Prepared statement

Gekas, Hon. George W., a Representative in Congress from the State of Pennsylvania: Prepared statement

Hildebrand, Henry E., III, Esquire, Chapter 13 Trustee, Nashville, TN, on behalf of the National Association of Chapter 13 Trustees: Prepared statement

Klee, Kenneth, Professor, University of California-Los Angeles School of Law, Los Angeles, CA, on behalf of the National Bankruptcy Conference: Prepared statement

Moore, Michael, Badcock Home Furnishing Centers, Gainesville and Cornelia, GA, on behalf of the National Retail Federation: Prepared statement

Page 8 PREV PAGE TOP OF DOC

Neubig, Thomas S., Ernst & Young LLP, Washington, DC: Prepared statement

Newsome, Randall J., United States Bankruptcy Judge, Northern District of California, Oakland, CA, on behalf of the National Conference of Bankruptcy Judges: Prepared statement

Ryu, Lisa H., Staff Economist, the National Association of Federal Credit Unions, Washington, DC: Prepared statement

Sigmon, Wayne, Esquire, Gray, Layton, Kersh, Solomon, Sigmon, Furr and Smith, PA, Gastonia, NC, on behalf of the National Association of Consumer Bankruptcy Attorneys: Prepared statement

Staten, Michael E., Professor and Director, Credit Research Center, McDonough School of Business, Georgetown University, Washington, DC: Prepared statement

Tassey, Jeffrey A., Senior Vice President of Governmental and Legal Affairs, American Financial Services Association, Washington, DC: Prepared statement

Waldschmidt, Robert, Esquire, Chapter 7 Trustee, Nashville, TN, on behalf of the National Association of Bankruptcy Trustees: Prepared statement

Wallace, George J., Esquire, Eckert, Seamans, Cherin & Mellott, LLC, Washington, DC, on behalf of the Consumer Bankruptcy Reform Coalition: Prepared statement

Page 9 PREV PAGE TOP OF DOC

White, Michaela M., Professor, Creighton University School of Law, Omaha, NE: Prepared statement

Zywicki, Todd, Professor, George Mason University School of Law, Arlington, VA: Prepared statement

BANKRUPTCY REFORM ACT OF 1999, PART II

WEDNESDAY, MARCH 17, 1999

House of Representatives,
Subcommittee on Commercial
and Administrative Law,
Committee on the Judiciary,
Washington, DC.

The subcommittee met, pursuant to call, at 10 a.m., in Room 2141, Rayburn House Office Building, Hon. George W. Gekas [chairman of the subcommittee] presiding.

Present: Representatives George W. Gekas, Ed Bryant, Steve Chabot, Asa Hutchinson, Joe Scarborough, Jerrold Nadler, Melvin L. Watt, Anthony D. Weiner and William D. Delahunt and Sheila Jackson Lee.

Majority staff present: Susan Jensen-Conklin, Subcommittee Counsel; Raymond V. Smietanka, Subcommittee Chief Counsel; James W. Harper, Subcommittee Counsel; Peter Levinson, Full Committee Counsel; and Audray Clement, Subcommittee Staff Assistant.

Page 10 PREV PAGE TOP OF DOC

Minority staff present: David Lachmann, Minority Professional Staff Member.

OPENING STATEMENT OF CHAIRMAN GEKAS

Mr. **GEKAS.** The hour of 10 o'clock having arrived, the committee will come to order.

And because, as anyone can plainly see, there is no committee and nothing to come to order, we must recess until the appearance of at least one other member to constitute the hearing quorum required by the rules of the House. We have kept faith with our intent to begin every meeting and every hearing on time, albeit, many times it is necessary to recess until procedural mandates can be met. We will now stand in recess.

[Recess.]

Mr. **GEKAS.** Noting the arrival of the gentleman from Ohio, Mr. Chabot, a member of the committee, a hearing quorum has been accomplished; and the recess has expired.

We will ask for the time being that the members of the first panel take their places, we will dutifully introduce them, and then we will suspend the beginning of their testimony until we have opening statements, if any, from the members.

Page 11 PREV PAGE TOP OF DOC

So we will start by introducing the panel with, first, George J. Wallace, a member of the Washington, DC, office of the law firm Eckert, Seamans, Cherin & Mellott. His practice includes the representation of debtors and creditors in commercial and consumer cases. He has also specialized in consumer financial services law.

Before joining his present firm, Mr. Wallace was associated with the New Jersey law firm of Archer & Greiner in New Jersey and later served as general counsel for the Travelers Mortgage Services, Inc.

In addition to these endeavors, Mr. Wallace was a professor of law for 15 years. He taught at several institutions, including the University of Iowa College of Law from 1968 to 1978.

In addition to teaching bankruptcy law, he served as a faculty advisor to a low-income legal clinic that he started in Davenport, Iowa. He has also served as a trustee and debtors counsel.

Joining him at the witness table is the Honorable William Houston Brown, who was appointed U.S. Bankruptcy Judge for the Western District of Tennessee in 1987. And, as he has indicated personally to me, he considers himself a resident of Memphis.

Prior to that appointment, Judge Brown was an Associate Professor of Law at the University of Mississippi College of Law, where he was also the Director of Clinical Education.

Page 12 PREV PAGE TOP OF DOC

He graduated first in his class and was elected to the Order of the Coif at the University of Tennessee College of Law where he received his law degree.

In addition to a bachelor of arts degree, Judge Brown holds a master's degree in American history.

Judge Brown has published extensively and has active and continuing legal education programs throughout the United States. He also serves on the board of directors of the American Bankruptcy Institute and is a fellow of the American College of Bankruptcy. He is a cochair of ABI's Consumer Bankruptcy Committee.

Most recently, Judge Brown began a term on the Bankruptcy Appellate Panel of the Sixth Circuit in January of this year.

With us again is Professor Todd Zywicki, who teaches bankruptcy and contracts at George Mason University School of Law where he has been an Assistant Professor of Law since 1998. Prior to joining the faculty at George Mason, he was an Assistant Professor of Law at Mississippi College School of Law from 1996 to 1998.

Professor Zywicki began his legal career as a law clerk for Judge Jerry E. Smith of the Fifth Circuit Court of Appeals. Professor Zywicki received his juris doctor degree from the University of Virginia in 1993. He received a master's degree in economics from Clemson University in 1990, and his undergraduate degree cum laude from Dartmouth College in 1988.

Page 13 PREV PAGE TOP OF DOC

He has written extensively on the subjects of bankruptcy, environmental law, constitutional law and history, among other areas. Most recently, he has coauthored with Judge Jones in a law review article entitled, "It Is Time for Means Testing."

Professor Zywicki is a cofounder of the Bankruptcy Subcommittee at the Federalist Society.

With him is Professor Klee, well-known to our committee and to those active in the efforts in bankruptcy reform is an Acting Professor of Law at UCLA Law School where he teaches courses in bankruptcy, chapter 11 reorganization law, and related subjects.

During 1995 through 1996, he served as the Robert Braucher Visiting Professor of Law at Harvard Law School, where he taught bankruptcy and business reorganization law.

In addition to his academic endeavors, Professor Klee is of counsel with Stutman, Treister & Glatt, a law firm that specializes in corporate reorganization, insolvency and bankruptcy law.

Professor Klee received his bachelor of arts with great distinction from Stanford University. He thereafter earned his juris doctor degree cum laude from Harvard Law School in 1974.

Professor Klee began his professional career as Associate Counsel to the Judiciary Committee for the House of Representatives, where he was one of the principal drafters of the Bankruptcy Reform Act of 1978.

Page 14 PREV PAGE TOP OF DOC

In addition to his many publications, Professor Klee has lectured extensively; and, in 1992, he was appointed by Chief Justice Rehnquist to serve as a member of the Judicial Conference's Advisory Committee of Bankruptcy Rules and currently serves as chairman of the Advisory Committee's Litigation Subcommittee.

They are joined by Jeffery A. Tassey, Senior Vice President of Governmental and Legal Affairs at the American Financial Services Association. Mr. Tassey is responsible for coordinating the Association's responses to all legislative and regulatory initiatives affecting the financial services industry.

Before joining the Association, Mr. Tassey served as Counsel to the House Committee on Government Operations and the Commerce, Consumer and Monetary Affairs Subcommittee, where he conducted public hearings and performed legislative oversight activities pertaining to financial institution regulation. He also served as banking counsel and legislative director to the Honorable Doug Barnard, former Member of Congress.

Mr. Tassey is a graduate of the college of Wooster, and he received his law degree from Washington University School of Law. He was awarded a public affairs fellowship at the Hoover Institution at Stanford University.

Then we have Michael Moore, the independent owner and operator of two Badcock Home Furnishing Centers located in Gainesville and Cornelia, Georgia. He appears today on behalf of the National Retail Federation, which is the world's largest retail trade association. The Federation's membership comprises all retail formats and channels of distribution including department, specialty, discount, catalog, Internet and independent stories.

Page 15 PREV PAGE TOP OF DOC

Mr. Wayne Sigmon, Esquire, has practiced almost exclusively in the area of bankruptcy law for the past 20 years and is certified as a specialist in bankruptcy law by the North Carolina State Bar Board of Legal Specialization.

He graduated from North Carolina State University in 1972 with a bachelor of science degree in industrial engineering with honors. And in 1976, he earned a juris doctor degree from Stetson University School of Law.

Mr. Sigmon is a member of the National Association of Consumer Bankruptcy.

Mr. **BRYANT.** Mr. Chairman——

Mr. **GEKAS.** Governor Carper?

Mr. **BRYANT.** May I have a point of personal privilege?

Mr. **GEKAS.** A point of personal privilege is recognized. The gentleman raises to ask what?

Mr. **BRYANT.** Well, I would just add, if I could, my apology for being late to this hearing, but I did miss the introduction of a colleague of mine, a former colleague of mine, Judge Brown, and I might—might I just say a word or two about him?

Mr. **GEKAS.** We will consider this your opening statement.

Page 16 PREV PAGE TOP OF DOC

Mr. **BRYANT.** That would be great.

I did notice on the panel list today that we have a number of very qualified people from Tennessee talking about this important issue of bankruptcy. But I did want to—I want to especially note Judge Brown, who I just alluded to as a former colleague. We practiced law together a short period of time.

During his career, he was of counsel with our law firm, and at the same time he taught law school, and he is imminently qualified. We were very fortunate in the Western District of Tennessee especially to have the brightest panel of judges and people who help them—their staff, I think, as any district in the country. And Judge Brown certainly exemplifies that. And certainly, if all the other panel members today and this panel and the other panels are as qualified as Bill Brown is, then I expect a very good hearing today, Mr. Chairman. And I thank you for calling it.

Mr. **GEKAS.** We thank the gentleman.

We want the record to indicate that currently present at the hearing is, along with the gentleman from Ohio, Mr. Chabot; the gentleman from Tennessee, Mr. Bryant; the gentleman from North Carolina, Mr. Watt; whom we now recognize for any opening statement that he might wish to make.

Mr. **WATT.** Thank you, Mr. Chairman.

Page 17 PREV PAGE TOP OF DOC

I won't make an opening statement; but I, like Mr. Bryant, wanted to especially welcome a member of the panel, Mr. Sigmon, who is from North Carolina, from Gastonia, North Carolina, which is near and dear to my heart because it is in Gaston County which is where my wife was born.

Mr. Sigmon has quite often given me the benefit of his opinions on the bankruptcy issues that this panel faces; and, most recently, when he gave me the benefit of his opinions on the bill, I think that resulted in him being invited to be here today. So I wanted to extend a special thanks to him for his willingness and time commitment to this. Thank you.

Mr. **GEKAS.** The gentleman yields back the balance of his time.

We recognize the gentleman from Ohio, if he should have any opening statement.

Mr. **CHABOT.** Thank you, Mr. Chairman.

I don't really have any opening statement, but I would like the chairman to take judicial notice, even though there is nobody from Ohio on the panel, we have some great judges in Ohio as well. Thank you.

Mr. **GEKAS.** We thank the gentleman.

The hearing today will be comprised of three panels, which we feel very good about on the basis that we are going to cover the three main aspects of our effort at bankruptcy reform. That is the need for reform generally, which will be the subject matter of the first panel; and they will give us the benefit of their experience, et cetera, in the whole world of bankruptcy, as it were.

Page 18 PREV PAGE TOP OF DOC

The second panel will be discussing the administrative and judicial issues that pertain to any effort at reform; and the third will concentrate on the needs-based approach for consumer bankruptcy that has become the most talked about and controversial feature of our now second session effort in trying to bring about what we consider to be needed bankruptcy reform.

With that in mind, we have set the stage then to allow for full participation by members of the committee in every phase of what the bill that we have offered contains, and we will allow for further consideration of these issues as we move down the path toward markup.

With that, then, we will begin with the first witness, who is, as we indicated, Mr. Wallace. We state uniformly for this panel and the others that the written statements will be accepted for the record, without objection, and we will ask each witness to try to circumscribe their oral testimony in review of that written testimony within 5 minutes.

[The prepared statement of Mr. Gekas follows:]

PREPARED STATEMENT OF HON. GEORGE W. GEKAS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA, AND CHAIRMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Today marks the third hearing that this Subcommittee is holding on the important subject of bankruptcy reform. Over the course of today's hearing, there will be three sets of panel presentations.

Page 19 PREV PAGE TOP OF DOC

For the first panel, nearly every major organization in the bankruptcy community will share their various perspectives on consumer bankruptcy reform. These groups include the American Bankruptcy Institute, the American Financial Services Association, the National Association of Consumer Bankruptcy Attorneys, the National Bankruptcy Conference, the National Consumer Bankruptcy Coalition, and the National Retail Federation.

We are also most especially pleased that Governor Tom Carper of Delaware, one of our former colleagues, will later join us on behalf of the National Governors' Association. We very much appreciate his personal commitment and that of the Association to the need for bankruptcy reform.

The second panel will focus on judicial and administrative aspects of consumer bankruptcy reform. And, finally, the hearing will conclude with a panel that will provide an analysis of the needs-based reforms in H.R. 833.

Mr. **GEKAS.** Mr. Wallace.

STATEMENT OF GEORGE J. WALLACE, ESQUIRE, ECKERT, SEAMANS, CHERIN & MELLOTT, LLC, WASHINGTON, DC, ON BEHALF OF THE CONSUMER BANKRUPTCY REFORM COALITION

Mr. **WALLACE.** Thank you very much, Mr. Chairman.

Mr. Chairman and members of the subcommittee, thank you for this opportunity to express my views on consumer bankruptcy reform and H.R. 833, the Bankruptcy Reform Act of 1999.

Page 20 PREV PAGE TOP OF DOC

I represent the Consumer Bankruptcy Reform Coalition, a broad coalition of consumer creditors, including banks, credit unions, savings institutions, retailers, mortgage companies, sales finance companies and diversified financial services providers, all of which support bankruptcy reform.

My name, of course, is George Wallace. I have already been introduced. I am a member of the law firm of Eckert, Seamans, Cherin & Mellott, which is a Washington, DC, office.

The coalition strongly supports H.R. 833. It does so because the legislation is a balanced compromise which addresses the major reform needs of today consumer's bankruptcy law.

As you know, the bill is identical to the conference report developed at the end of last Congress as a compromise between the Senate and House versions of H.R. 3150, in light of being introduced by the chairman of this subcommittee, along with Mr. Boucher. It passed this House by over 300 votes. It contained provisions from both the bills which passed the House and Senate, some of which were proposed by Democrats, some by Republicans.

More importantly, the resulting legislation is balanced, well-thought-out reform. It requires borrowers who have the ability to repay some part of their debts to do so, imposes new forms of consumer protection on both the bankruptcy process and on consumer credit extension, recognizes the importance of secured credit to Americans, and significantly improves the position of women and children who are dependent upon child support, alimony and marital property settlements.

Page 21 PREV PAGE TOP OF DOC

Of course, there are those who oppose this legislation, even though it is good, balanced reform. Such opposition is inevitable.

Professor Klee, who I understand is here to oppose this bill, proposed 2 years ago his own version of consumer bankruptcy reform, the centerpiece of which was a requirement that anyone who filed bankruptcy and had a gross income of over $50,000 a year would have to pay 75 percent of their disposable income to creditors.

In making this proposal, he wrote, the incumbency guarantees that radical reform will be opposed vigorously by creditors, lawyers, accountants, judges, court staff and others who benefit from the current system. Irrespective of truth, some of these incumbents will make the "Chicken Little" argument that dramatic change to the current system is dangerous and will cause the sky to fall. You will hear a lot of that today.

The complaints of the critics should not obscure what is happening here. The critics are those with a vested interest in the system staying exactly as it is. They do not want reform. The American people, on the other hand, recognized all too clearly that bankruptcy is being used by some people to avoid their responsibilities. In repeated polls of the public, they respond that bankruptcy reform is needed and necessary.

Make no mistake about the point I am making here, we support the availability of consumer bankruptcy relief. H.R. 833 would continue to make available to every American on demand the ability to go into bankruptcy, obtain the benefit of the automatic stay and a discharge for unsecured debts and emerge with a fresh start. We support that.

Page 22 PREV PAGE TOP OF DOC

Nothing in this bill would prevent a person from getting prompt, effective and compassionate bankruptcy relief. Those who claim the contrary are simply uninformed. But reform is urgently needed. Today's bankruptcy system is really two systems. It is a system for those who are overburdened with debt that are responsibly using the bankruptcy system. That is the vast majority of bankruptcy users. By our estimates, it is about 80 to 90 percent of the bankruptcy users.

But there is another group which uses the bankruptcy system irresponsibly. These people usually have a great deal of debt and so on the surface are indistinguishable from their fellows. But they use the bankruptcy system to evade their personal responsibilities. We estimate this group to be no larger than 10 or 20 percent of the bankruptcy users, but they are, nonetheless, significant.

At present bankruptcy filing rates, 10 percent is 100,000 people a year. In other words—or 140,000 people per year, depending on how you count it. In other words, bankruptcy is a good social program which provides benefits to

Americans but which is sometimes used inappropriately. We do not tolerate abuse of other social programs, such as Medicare and welfare, nor should we tolerate abuse of bankruptcy.

How can we misuse the bankruptcy system, you may ask? Let me give you a few examples.

Do you owe $40,000 of unsecured debt but have a comfortably steady income so you can repay it over a few years? File chapter 7 and discharge the $40,000. Enjoy your comfortably steady income.

Page 23 PREV PAGE TOP OF DOC

That can be done today. H.R. 833 addresses this misuse of the bankruptcy system with the ability to pay provisions of section 102. This reform is urgently needed.

Do you owe child support? Use chapter 13 to stop collection of child support cold, propose a plan that pays off child support over 5 years without interest.

Can you do that today? Yes. H.R. 833 lifts the automatic stay in the chapter 13 case when the State is collecting the child support, and the State collects child support both for those who are FDIC recipients and for those who simply request it and are not on welfare. This is extremely important because of the need for a single parent family to receive regular income to pay for food and shelter.

Do you owe a $40,000 property settlement payment to an ex-wife? File chapter 7. If she doesn't hire a lawyer and file an action to determine dischargeability of that debt, it will be discharged. And may I say that she will have no idea what is happening because all she gets is a piece of paper in the mail that says that a bankruptcy has been filed. However, if she does hire a lawyer and wakes up, she can object, and you will dismiss the chapter 7 and file a chapter 13 where those marital obligations will be discharged.

This is outrageous. H.R. 833 addresses this misuse by making property settlement agreement obligations nondischargeable. They are not nondischargeable in chapter 7 today, they are only dischargeable if you cannot prove that they are not a hardship.

Have you defrauded your creditors? Use chapter 13 to discharge the debts you incurred by fraud.

Page 24 PREV PAGE TOP OF DOC

Can you do that today? Yes. H.R. 833 stops this abuse. To incur debt by fraud, it is not discharged.

Do you owe significant back taxes and have you recently purchased a new car on credit? Use chapter 13, and its cramdown provisions to take money from your secured creditors and use it to pay your taxes.

Can you do that today in chapter 13? Yes. H.R. 833 stops this misuse. It controls the use of cramdowns in purchase money credit situations.

Each of the examples I have given you are all perfectly legal strategies under today's Bankruptcy Code, and they all illustrate what is wrong. We have created a form of debt relief that rightly takes care of those who need it but fails to identify and treat differently those who do not or who are using it irresponsibly.

Mr. **GEKAS.** We have to ask you to get to your concluding statement, Mr. Wallace.

Mr. **WALLACE.** I am getting there.

Balanced reform is needed to put our consumer bankruptcy laws back on track. H.R. 833 is balanced reform, and we support it.

Let me add one more point. The bill has enormously strong provisions to make sure that child support, alimony and property settlement obligations are not evaded in bankruptcy. I have heard no one who says that those changes are not enough. And they are needed to make sure that these important social responsibilities are not evaded in bankruptcy court.

Page 25 PREV PAGE TOP OF DOC

Thank you. And I will be glad to answer questions later on.

Mr. **GEKAS.** Yes. We will explore some of the points you made during the question and answer period.

[The prepared statement of Mr. Wallace follows:]

PREPARED STATEMENT OF GEORGE J. WALLACE, ESQUIRE, ECKERT, SEAMANS, CHERIN & MELLOTT, LLC, WASHINGTON, DC, ON BEHALF OF THE CONSUMER BANKRUPTCY REFORM COALITION

SUMMARY

Despite a strong economy, low inflation, a very strong job market, and boom times, the numbers of Americans who use consumer bankruptcy continues to rise rapidly. As consumer bankruptcy filings have increased dramatically, the failures and inefficiencies of the present bankruptcy system have been magnified. What was tolerable when only 280,000 consumer bankruptcies occurred per year becomes unacceptable when there are 1.4 million per year, because the impact on our society is so much larger.

Today, we have a chapter 7 bankruptcy remedy which is fundamentally flawed. At the same time, we have a chapter 13 program which is supposed to encourage consumers to repay their debts, but instead encourages them all too often to evade their responsibilities. In a well meaning attempt to help those in debt trouble, a major "reform" of bankruptcy was enacted in 1978 which generously provides relief to those who need it—but also to those who do not deserve it. Unfortunately, bill paying Americans pay for that unnecessary largess in higher credit prices and reduced credit availability.

Page 26 PREV PAGE TOP OF DOC

Balanced reform is needed to put our consumer bankruptcy laws back on track. H. R. 833 is balanced reform which addresses the major failings of the present bankruptcy system. It limits chapter 7 relief to those with ability to pay and it addresses well known abuses of chapter 7 and chapter 13. In addition, it incorporates important new consumer protections.

The Bill puts *personal responsibility* back into consumer bankruptcy. Consumers must consider credit counseling, and they must pay their creditors what they can afford.

Effective, quickly available and compassionate consumer bankruptcy relief will continue to be available for Americans who need it. Anyone who can get bankruptcy relief today will get relief under the Bill, although some will get different relief.

New Consumer Protections. The Bill contains significant new consumer protections.

Relief for Those Who Pay Their Bills. The American consumer who is working hard paying his bills will no longer pay for those who abuse bankruptcy.

Creditors must behave responsibly. If consumer credit is not being responsibly extended, the Federal Reserve Board is authorized to act.

Bankruptcy is an extraordinary remedy, and it should continue to be perceived as such by all Americans. H.R. 833 helps the honest, deserving debtor while limiting misuse of the bankruptcy process.

Page 27 PREV PAGE TOP OF DOC

STATEMENT

I appreciate this opportunity to express my views on consumer bankruptcy and H.R. 833, "The Bankruptcy Reform Act of 1999."

I represent the Consumer Bankruptcy Reform Coalition, a broad coalition of consumer creditors, including banks, credit unions, savings institutions, retailers, mortgage companies, sales finance companies and diversified financial services providers. The Coalition strongly supported bankruptcy reform efforts in the last Congress, and strongly supports H.R. 833 as introduced.

I am a member of the law firm of Eckert Seamans Cherin & Mellott LLC and am resident in the Washington, D.C. office. My practice includes bankruptcy representation of debtors and creditors.

For fifteen years before I began practice full time, I was a professor of law, the longest period of time at the University of Iowa College of Law from 1968 to 1978. During this time I taught bankruptcy law and also learned about the day to day realities of bankruptcy practice in my role as the faculty advisor to the low income legal clinic I started in Davenport Iowa, as well as in serving as a trustee or debtor's attorney in a few cases. I also learned something about what a bankruptcy judge faces as the faculty advisor to student bankruptcy law clerks for the bankruptcy judge in the Northern District of Iowa during the 1970s, reviewing and editing the draft opinions the students prepared for the judge.

Since then, I have practiced law full time for seventeen years, first with Archer & Greiner in New Jersey, then as General Counsel of The Travelers Mortgage Services, Inc., and finally with my present firm.

Page 28 PREV PAGE TOP OF DOC

We strongly urge Congress to reform the consumer bankruptcy law as quickly as possible. The need is urgent. Despite a strong economy, low inflation, a very strong job market, and boom times, the numbers of Americans who use consumer bankruptcy continues to rise rapidly. In 1998, there were 1,398,182 consumer bankruptcies filed, up from 287,570 in 1980 and 718,107 in 1990. In other words, 1998 consumer bankruptcy filings were 5 times those in 1980. A significant indication of the trend is shown by the increase in how many *bankruptcy filings* are *consumer filings*. In 1980 during a major recession, 86.81% of total bankruptcy filings were consumer bankruptcy filings. As of the end of 1998, consumer bankruptcies had increased to 96.92% of bankruptcy filings. Meanwhile, over this same period of time, consumers' ability to pay, as measured by the ratio of net income or take home pay to scheduled debt payments, remained about the same.

As consumer bankruptcy filings have increased dramatically, the failures and inefficiencies of the present bankruptcy system have been magnified. What was tolerable when only 280,000 consumer bankruptcies occurred per year becomes unacceptable when there are 1.4 million per year, because the impact on our society is so much larger. The Bankruptcy Code was last significantly reformed in 1978. That reform changed the procedural and substantive law of consumer bankruptcy, expanding the type of relief a consumer could obtain. Today, we have a chapter 7 bankruptcy remedy which is fundamentally flawed. At the same time, we have a chapter 13 program which is supposed to encourage consumers to repay their debts, but instead encourages them all too often to evade their responsibilities.

What we urge Congress to enact is a balanced, fair consumer bankruptcy system which continues to provide the truly needy with prompt, fairly balanced relief from overburdening debt. But there can be no doubt that the present

Bankruptcy Code fundamentally distorts that mission. Here are some examples about how you can misuse consumer bankruptcy today—

Page 29 PREV PAGE TOP OF DOC

Do you owe $40,000 of unsecured debt but have a comfortably steady income so that you could repay it over a few years? File chapter 7 and discharge that $40,000. Enjoy your comfortably steady income.

Do you owe child support? Use Chapter 13 to stop collection of child support. Propose a plan that pays off the child support over five years without interest.

Owe a $40,000 property settlement payment to an ex-wife? Or perhaps as part of that property settlement you are supposed to pay the mortgage every month on the house she occupies with the children. File chapter 7. If she doesn't hire a lawyer and file an action to declare the obligation you owe her nondischargeable, it will be discharged.(see footnote 1) If she does, dismiss the chapter 7 and file a chapter 13. You can discharge property settlement obligations in a chapter 13 proceeding.

Have you defrauded your creditors? Use chapter 13 to discharge the debts you incurred by fraud.

Do you owe significant back taxes and have you recently purchased a new car on credit? Use chapter 13 and its cramdown provisions to take money from your secured creditors and use it to pay your taxes.

These are all perfectly legal strategies under today's Bankruptcy Code, and they all illustrate what is wrong. How could this have happened? Briefly, in a well meaning attempt to help those in debt trouble, a statutory scheme was enacted in 1978 which generously provides relief to those who need it—but also to those who do not deserve it. Unfortunately, bill paying Americans pay for that unnecessary largess in higher credit prices and reduced credit availability.

Page 30 PREV PAGE TOP OF DOC

Balanced reform is needed to put our consumer bankruptcy laws back on track. H. R. 833 is balanced reform. As you know, the bill is the result of compromises worked out at the end of the last Congress in Conference. Like most compromises, the bill doesn't satisfy everyone. Apologists for the present bankruptcy system have made their dissatisfaction well known. From our point of view, we think the bill could go considerably farther in addressing opportunities the present Bankruptcy Code gives debtors to misuse the system. For example, we think the opportunity to use revolving credit on the eve of bankruptcy, as compromised in the bill, is not strong enough even though it is an improvement over present law. Both the House and Senate bills that preceded the Conference had stronger provisions on this and many other provisions. Nonetheless, we strongly support H.R. 833 as a major and long overdue step in the right direction.

H.R. 833 addresses the major failings of the present bankruptcy system. It limits chapter 7 relief to those with ability to pay and it addresses well known abuses of chapter 7 and chapter 13. In addition, it incorporates important new consumer protections.

Highlights of H.R. 833

The Bill puts *personal responsibility* back into consumer bankruptcy. Consumers must consider credit counseling, and they must pay their creditors what they can afford.

Effective, quickly available and compassionate consumer bankruptcy relief will continue to be available for Americans who need it. Anyone who can get bankruptcy relief today will get relief under the Bill, although some will get different relief.

Page 31 PREV PAGE TOP OF DOC

Relief for Those Who Pay Their Bills. The American consumer who is working hard paying his bills will no longer pay for those who abuse bankruptcy.

Creditors must behave responsibly. If consumer credit is not being responsibly extended, the Federal Reserve Board is authorized to act.

New Consumer Protections. The Bill contains significant new consumer protections (see attachment).

Major Changes:

Needs Based Bankruptcy and Personal Responsibility

The chapter 7 cases of debtors with the ability to pay either 25% of their unsecured, non-priority debts or $5,000 will be dismissed by the bankruptcy court or converted to chapter 13.

If the debtor has ability to pay, dismissal is presumed. The debtor can rebut the presumption if he can show he lacks the ability to pay. As the attached flow chart shows, ability to pay is determined by a simple, two step test which can be easily administered.

The debtor's expenses are limited according to IRS standards for expense.

A debtor can demonstrate that he has unusual and justifiable expenses, or uncertain income, and stay in chapter 7.

Page 32 PREV PAGE TOP OF DOC

To assist enforcement and better guide debtors into the right chapter, debtors must include the needs based calculations in their schedules.

The panel trustee or bankruptcy administrator must review the schedules and ten days before the first meeting of creditors file a report as to whether the debtor's case is presumed to be one that should be dismissed. A copy of that statement must be given each creditor within 5 days.

The panel trustee must bring the case of anyone who has the ability to pay to the attention of the court.

Creditors of a debtor whose income is over the national median income can bring a motion requesting the chapter 7 case be dismissed assuming the trustee does not.

To assist enforcement, debtors must provide their tax returns and most recent pay stubs. Regular auditing of the information debtors provide also assists enforcement.

Credit Counseling

Debtors are required to consult with an approved credit counseling program within the 90 days before they file. There is a hardship exception.

Child Support

Use of bankruptcy to evade child support and marital dissolution obligations is stopped.

Page 33 PREV PAGE TOP OF DOC

Child support is placed in first priority.

Unlike today, debtors must continue to pay child support when they file bankruptcy.

Bankruptcy will not discharge the debtor's debts until child support is brought current.

Unlike today, property settlement obligations will be flatly nondischargeable.

New Protections to Help Debtors and Their Children

Two new *exemptions* are provided for debtors.

Retirement Plans. Retirement plan assets are protected completely from the claims of creditors, even if state exemptions are otherwise claimed.

Postsecondary Education Savings. Postsecondary education accounts are protected from creditor claims to the extent they do not exceed $50,000 per child or in the aggregate $100,000.

New Consumer Protection

Bankruptcy Practices:

Debtor's Bill of Rights. The debtor's bill of rights *for the first time* requires that consumers be informed about what to expect in bankruptcy and protected from the unscrupulous practices of those who "low ball" the price for a bankruptcy and then extract high fees after the case is filed to defend bankruptcy litigation.

Page 34 PREV PAGE TOP OF DOC

Reaffirmations. Even if a debtor is represented by an attorney, reaffirmations of "wholly unsecured" debt will not be legal unless the creditor gives new disclosures when the debtor signs, and the *reaffirmation is reviewed by a bankruptcy judge*. The debtor can waive the hearing if the debtor chooses to do so.

Pressuring Debtors After Discharge. Violations of the post discharge injunction result in a penalty of $1,000, collectible only in individual actions, plus actual damages and attorneys fees.

Abusive Reaffirmation Practices. Creditor failure to follow the procedures for a reaffirmation agreement if that failure injures the debtor results in a penalty of $1,000, collectible only in individual actions, plus actual damages and attorneys fees.

Refusal to Credit Plan Payments Properly. Willful creditor failure to credit payments received under a plan in chapter 11, 12 or 13 "in the manner required by the plan" results in a penalty of $1,000, collectible only in individual actions, plus actual damages and attorneys fees.

Unjustified Dismissal Motions. If creditors bring unjustified actions against debtors claiming their chapter 7 cases should be dismissed, or do so to coerce a debtor improperly, they will be liable for the debtor's attorney fees and costs.

Excessive Claims. A court may decrease a creditor's claim by *up to 20%* if a credit counseling agency has made a good faith offer to the creditor within 60 days of the petition for 60% of what was owed and the creditor refused it unreasonably.

Page 35 PREV PAGE TOP OF DOC

Bank and other creditor practices

Cutting Off Credit. The Truth in Lending Act is amended to provide that a credit card company, or any other open end creditor, cannot terminate a customer's account solely because the debtor has not incurred finance charges on the account.

Credit Card Minimum Payment Practices. New Truth in Lending disclosures are required for open end credit. These new disclosures affect the initial and periodic statement disclosures, and require a new annual disclosure. The Board is to provide model disclosures. The Board is also to study whether consumers have enough information about borrowing and financial difficulties, and the Board can issue new regulations if it concludes consumers do not have an adequate understanding of open end credit practices in relation to the minimum payment. These disclosures will not go into effect before January 1, 2001.

Initial Disclosures. These must include a statement warning that the minimum statement may increase the finance charges paid or the length of time it takes to repay the loan. An example must also be included which shows how long it will take a $500 balance to be paid off under the plan at the minimum payment, and the amount of the minimum payment.

Periodic Statement Disclosures. A statement warning that the minimum payment will increase the amount of interest and length of time to pay off the obligation must be made on each statement.

Annual Disclosures. The same disclosure will be provided existing customers once a year, together with a worksheet to determine the consumer's household income and debt obligations.

Page 36 PREV PAGE TOP OF DOC

Over 100% LTV Mortgage Credit. Disclosures for closed and open end credit secured by the debtor's house will be studied by the Federal Reserve Board to determine if they are adequate for transactions which are more than 100% LTV. The Board is authorized to issue disclosure regulations if it finds there is a problem.

Overextension to College Students. The Comptroller General of the United States is to conduct a study whether the extension of credit to college students is excessive. The report must be provided within one year.

Debit Cards. The Federal Reserve Board will study whether the existing procedures for limiting consumer liability with debit cards are sufficient. The Board is authorized to issue disclosure regulations if it finds there is a problem.

General Changes That Affect Consumer Creditors

Multiple Filing. The multiple filing problem is strongly addressed with restrictions on repeat filers. A strong in rem order giving relief from stay is also provided to stop those who do serial filing.

Better Information. Better and quicker access to information about what is going on in the case will be provided.

Exemptions. The debtor can rely only on the exemptions of the place that he or she has lived for a period of 2 or more years. Moving to a new place to get better exemptions before filing bankruptcy is stopped. In addition, a creditor or trustee can avoid a transfer of non-exempt assets into exempt real property or similar assets within 2 years of bankruptcy with intent to defraud creditors.

Page 37 PREV PAGE TOP OF DOC

Stopping Use of Bankruptcy to Discharge Fraud. The superdischarge—the practice of using chapter 7 to discharge fraudulent debts—is stopped.

Fairer Notice. Both debtors and the court must provide better notice to creditors about bankruptcy commencement and proceedings which occur during the case.

Drunk Drivers. Priority is given to the payment of judgments against drunk drivers and drug users.

Prompt Resolution of Lift of Stay. Lift stay proceedings are limited to sixty days.

How Frequently a Debtor Can File Another Bankruptcy. The period between bankruptcy discharges is extended to 8 years for a chapter 7 and 5 years for a chapter 13. Now the periods are 6 years and zero years, respectively.

Participation of Paralegals. Nonlawyers can attend and participate in the first meeting of creditors.

Treatment of Secured Creditors and Lessors

Cramdown. Purchase money creditors secured by purchased personal property will be protected from cramdown or fair market value redemption if the property was purchased within five years of filing.

Page 38 PREV PAGE TOP OF DOC

Limits on Avoiding Nonpurchase Money Security Interests. The bankruptcy Code permits a debtor to void a nonpurchase money security interest in "household goods" that are exempt property. Although this provision has been in the law since 1978, household goods are defined for the first time. The definition is derived from the list of household goods developed in the Federal Trade Commission's Credit Practices Rule, with the addition of one VCR, educational materials and equipment primarily for use of children (but only one personal computer), and children's toys or hobby equipment. Large ticket items are excluded like jewelry (other than the wedding ring), boats, personal watercraft and lawn tractors.

Delayed Perfection of Purchase Money Credit. Purchase money secured credit that is perfected within 30 days is protected from attack under the preference provisions. Non-purchase money credit is also given some protection if perfected within 30 days, although the protection is not as complete as for purchase money credit. This provision partially overturns the recent questionable U.S. Supreme Court decision in *Fidelity*.

Continuation of Payments. In a chapter 13 plan, contractual payments to secured creditors have to be continued until plan payments commence, an important change. Debtors will not be able to allow payments to stop during the period between filing and commencement of payments under the plan.

Fair Valuation. When a cramdown is permitted or personal property is otherwise valued in a bankruptcy, the fair market retail value of the goods will control for consumer goods, replacement value for commercial goods.

Page 39 PREV PAGE TOP OF DOC

No Ride Throughs. Ride throughs are not permitted unless the creditor consents.

No Lien Stripping Use of "lien stripping" is stopped. This is a practice of filing a chapter 13 plan, cramming down the secured creditor, paying off the allowed secured claim, and then converting to chapter 7 and discharging all the unpaid unsecured debt, including the unsecured portion of the unsecured creditor's balance.

Treatment of Personal Property Lessors

Continuation of Lease Payments. In a chapter 13 plan, lease payments have to be continued until plan payments commence, an important change. Debtors will not be able to allow payments to stop during the period between filing and commencement of payments under the plan.

Assumption of Leases. Personal property lessees can assume a lease, with the consent of the lessor, if the trustee rejects it.

Treatment of Unsecured Creditors

Needs Based Bankruptcy. Discussed above, the needs based provisions are helpful to unsecured creditors.

Credit Counseling. Credit counseling requirements will help unsecured creditors by helping debtors who can work out their debts outside bankruptcy do so.

Load Up Within 90 Days. The "load up" provisions of present law are revised so that a debt will be presumed to be nondischargeable if incurred on a credit card within 90 (as opposed to 60) days before the petition is filed and is for more than $250 of luxuries (as opposed to $1,000).

Page 40 PREV PAGE TOP OF DOC

Debts Incurred to Pay Nondischargeable Debts. Debts incurred within 90 days of filing bankruptcy that are used to pay nondischargeable debts are themselves nondischargeable. In addition, if debt is incurred prior to that 90 day period to pay a nondischargeable debt with the intent to discharge the new debt, that new debt is also nondischargeable.

Bankruptcy is an extraordinary remedy, and it should continue to be perceived as such by all Americans. Individuals who are currently availing themselves of the Bankruptcy remedy without adequate justification bring discredit to the system, and cause the honest borrower to pay more for credit. In her statement before the Subcommittee on Commercial and Administrative Law of the House Committee on the Judiciary on November 13, 1997, Circuit Court of Appeals Judge Edith R. Jones, a member of the National Bankruptcy Review Commission said:

. . . I cannot overemphasize that the time has come for Congress to consider whether the bankruptcy discharge and "fresh start" are widely being made available to individuals who could afford to repay some of their unsecured, non priority debts. From my experience on the Commission, I believe the discharge is being unjustifiably granted in a significant number of cases. Proportionately, these may not be a large share of overall bankruptcy filings, but taken together, they case disrespect on the system and impose large losses that ultimately must be borne by non-bankrupt consumers.
Statement of the Hon. Edith Hollan Jones, pp. 11–12 (1997).

I have confidence that this Congress will restore balance and fairness in the Bankruptcy Code. I believe that this is what most Americans want. I look forward to working with you in the effort to achieve this important goal.

Page 41 PREV PAGE TOP OF DOC

63593a.eps

63593b.eps

63593c.eps

63593d.eps

63593e.eps

63593f.eps

63593g.eps

63593h.eps

63593i.eps

Mr. **GEKAS.** We want the record now to indicate that the gentleman from Arkansas, Mr. Hutchinson, is present, and the gentleman from New York, the ranking member of the minority, is also in attendance. So now we will turn to Judge Brown.

STATEMENT OF WILLIAM BROWN, UNITED STATES BANKRUPTCY JUDGE, WESTERN DISTRICT OF TENNESSEE, NASHVILLE, TN, ON BEHALF OF THE AMERICAN BANKRUPTCY INSTITUTE

Page 42 PREV PAGE TOP OF DOC

Mr. **BROWN.** Thank you very much, and members of the subcommittee.

My name is William Houston Brown. I am the United States Bankruptcy Judge from the Western District of Tennessee, historically one of the high-volume chapter 13 districts in the United States. Currently, about 75 percent of our filings are under chapter 13.

I am appearing today, however, as a representative of the American Bankruptcy Institute, ABI, and, more specifically, as a cochair, along with Judge Eugene Wedoff of Chicago, of the ABI's Consumer Bankruptcy Committee.

ABI, as most of you know, is a nonprofit organization of over 6,500 professionals involved in the bankruptcy system, with members spanning the entire bankruptcy system—attorneys, accountants, judges, lenders, trustees, and others.

Our members represent both creditors and debtors in consumer and business cases. ABI is thus uniquely situated to attempt to find some common understanding on the shape of bankruptcy reform.

The consumer committee has been involved for over 1 year in bringing together a diverse but small group of individuals who have broad experience with the various views involved in the administration and practice of consumer bankruptcy law. This group, known as the ABI Consumer Bankruptcy Legislative Group, includes representatives of consumer debtors, automobile finance lenders, banking, both credit card and unsecured debt, credit unions and bankruptcy trustees, as well as judges.

Page 43 PREV PAGE TOP OF DOC

The group does not attempt to speak as an official voice of the ABI or its full membership, but it has been working in good faith to reach a consensus on a number of key elements of bankruptcy reform. In our meetings, we operate under a mutual promise of confidentiality until the full group is able to sign off on agreed recommendations.

The group's work product is still being circulated among the members for comment, and the group will meet again on April 5 and its goal is having a work product of recommendations addressing H.R. 833, as well as the new Senate bill, prepared for presentation to the full committee before the month of April or during the month of April.

The group's agreement is to produce a package of recommendations, rather than to preview a single one about one or two provisions of the reform bills. We believe that our commitment of confidentiality until the group's members sign off to release the recommendations has been a key to the group's progress toward consensus, because everyone knows they can talk freely and candidly without their views being expressed until they agree.

I want to emphasize, of course, that the members of this group have their own views individually about specific provisions of H.R. 833. But the group has been successful in working toward a consensus on a package of recommendations that are consistent with the goals of H.R. 833. This is not a group that is anti-change or anti-reform.

The ABI Consumer Group recognizes that many of the provisions of H.R. 833 are based upon legitimate underlying goals, such as reducing the number of abusive consumer filings. But the specific provisions of the bill present some significant problems of effective implementation. In many areas of the legislation, clarification of the proposed language or even substitution of alternatives would, we think, better carry out the bill's goals.

Page 44 PREV PAGE TOP OF DOC

There is a legitimate concern by both debtors and creditors that some of the bill's provisions will lead to results that are opposite from those intended.

For example, as to the means-testing provision of section 102, when you bring together experienced persons from both sides, creditor and debtor, there is confusion and disagreement about how that section is intended to work. Do you, for example, ever apply the test to debtors whose current monthly income falls below the median national income for their household size? Some say yes, some say no.

How do you account for the debtor's ongoing mortgage and other secured debt? Some read that test as permitting double counting of both the IRS standards and the actual debt. Obviously, it would not seem to be the intended purpose of the bill.

Do you permit people to use always their actual expenses for ongoing mortgages and car debt, for example? If so, most people would be exempt from the objective IRS standards.

This ABI Group is attempting and has been successful in discussing some alternative monetary measures that might make means testing more effective without resorting to the IRS standards. Our group, in fact, is progressing toward a consensus on details of a package of recommendations, including such things as how to give incentives to the panel chapter 7 trustees to bring successful 707(b) motions; how to protect creditors who have information they would like to give to the trustee but currently, under current law, nonbankruptcy law, may not be able to do so; how to make reaffirmations, especially of unsecured debt more effective for both creditors and debtors; how to encourage chapter 13 filings without destroying some of the incentives; how to value secured claims in consumer cases without at the same time harming unsecured creditors; and how to adequately protect secured creditors in chapter 13 without dooming otherwise feasible plans; as well as such things as how to assure effective notice to all creditors and effectively implement debtor education in consumer credit counseling.

Page 45 PREV PAGE TOP OF DOC

Our group, through the ABI consumer committee, is operating from the stages set by this committee in H.R. 833. We recognize the mood of Congress is one of reform, and our group wants to work with Congress in helping to bring about effective and workable changes. We believe that, given reasonable opportunities for negotiation of creditor and debtor groups, compromise is not only likely but can be accomplished.

Thank you. I would be happy to answer questions later.

Mr. **GEKAS.** We thank the gentleman.

[The prepared statement of Judge Brown follows:]

PREPARED STATEMENT OF WILLIAM BROWN, UNITED STATES BANKRUPTCY JUDGE, WESTERN DISTRICT OF TENNESSEE, NASHVILLE, TN, ON BEHALF OF THE AMERICAN BANKRUPTCY INSTITUTE

Mr. Chairman and members of the Subcommittee, my name is William Houston Brown, a U.S. Bankruptcy Judge in the Western District of Tennessee, in Memphis. I am appearing today as a representative of the American Bankruptcy Institute (ABI), a non-profit, non-partisan organization of bankruptcy professionals engaged in research and education on issues related to insolvency.

The ABI is the nation's largest organization in the field of bankruptcy, with over 6,500 members. ABI is not an advocacy group and does not take official positions on pending legislation. Rather, ABI provides a forum for the analysis and discussion of insolvency issues, which we hope will assist your understanding of the U.S. bankruptcy system. Our members come from many different disciplines: law, accounting, finance, judicial, administrative, academia, and more. ABI members represent both debtors and creditors, in both commercial and consumer cases. ABI's multi-disciplinary approach and outlook makes us unique among those who appear before Congress.

Page 46 PREV PAGE TOP OF DOC

Together with Judge Eugene R. Wedoff of Chicago, I Co-chair the ABI's Consumer Bankruptcy Committee. Judge Wedoff has prepared an analysis of the consumer bankruptcy provisions of H.R. 833, which we incorporate into this statement.

I have served as a bankruptcy judge in the Western District of Tennessee since 1987. Prior to that appointment, I practiced law, representing both debtors and creditors, and I have been a professor at three law schools.

My judicial district is one that has historically seen one of the highest numbers of consumer bankruptcy filings, with 16,749 Chapter 13 cases and 5,991 Chapter 7 cases having been filed in calendar year 1998, a small decline from calendar year 1997. My district's bankruptcy filings each year are approximately 75% Chapter 13's.

This experience influences my views of the law and system. As a bankruptcy judge, my principal task is to apply the law as Congress has written it, as well as applicable nonbankruptcy law, to the cases or proceedings before me. Whether I personally agree with those laws is not a consideration in my work as a judge. Likewise, in my participation in ABI's effort to analyze the pending bankruptcy reform legislation, I have attempted to leave aside my personal views in an effort to reach a compromise on certain recommendations that I will discuss today.

Bankruptcy law is complex and changes in the law often have unanticipated impacts upon not only the practice and administration of that law but also upon broader economic and policy issues. The ABI, through its members and its grants, has attempted to provide some analysis of the bankruptcy legislation that was pending before the 105th Congress as well as this Congress. For example, the ABI through a grant to Professors Marianne B. Culhane and Michaela M. White of Creighton University School of Law, provided an opportunity for another examination of means testing for Chapter 7 debtors and their repayment capacity. This subcommittee will be hearing from one of those professors in a later panel, and I will defer to her for testimony concerning their study.

Page 47 PREV PAGE TOP OF DOC

It is not surprising, of course, that all members of the ABI will not agree with the results of the Professors' study. Nor would all ABI members agree with my opinions or those of any other professional in the bankruptcy arena. That does not diminish the importance of Professors Culhane and White's study or of any other reports that result from ABI-sponsored work.

It would be impossible to expect that unanimity would occur in anything so complicated or controversial as bankruptcy reform. This subcommittee and the full Congress expect and deserve, however, the contribution of differing concepts and viewpoints as you work to craft an agreement on such reform.

Judge Wedoff and I have led an effort for over a year to bring together a small but diverse group of experienced professionals for a series of discussions on consumer bankruptcy reform. This ad hoc group consists of representatives of consumer debtors, banking (both credit card and secured lending), credit unions, automobile finance lenders, trustees (in both Chapter 7 and 13), accountants and bankruptcy judges.

This group, known as the ABI Consumer Bankruptcy Legislative Group, does not attempt to speak as an official voice of the ABI or its full membership. But that Group was able in its prior and continuing work to reach a consensus of those participants on many of the more difficult subjects being addressed in the current bankruptcy reform legislation.

I believe that this consensus is very significant because it illustrates that, despite personal differences of what each individual would prefer to see occur, professionals and those with experience in the bankruptcy system can come to agreement on compromises in many areas being considered in this legislation. I do not suggest that given enough time we could agree on everything, but I do urge the Representatives on this subcommittee, as well as the full Committee on the Judiciary, to consider the compromises that have been reached. During the 105th Congress, the ABI Consumer Bankruptcy Legislative Group sent a letter to Chairman Henry Hyde, along with a list of sixteen specific recommendations concerning reconciliation of the differences between H.R. 3150 and S. 1301 that were pending before the 105th Congress. A copy of those recommendations is available at ABI's Internet website at www.abiworld.org/legis/bills/hydeletter.html. Some of those recommendations have now become stale, as a result of changes made in the House Conference Report on H.R. 3150 and in H.R. 833. But, the group's recommendations in some areas have been validated by provisions of H.R. 833, such as a delay in the effective date for bankruptcy reform legislation in order to permit the system to adjust to dramatic change.

Page 48 PREV PAGE TOP OF DOC

That group continues to meet, as recently as March 10, in its ongoing effort to contribute a consensus of recommendations for your consideration.

I want to emphasis the working process of this ABI Consumer Bankruptcy Legislative Group. A pledge of confidentiality has been honored by the participants, to assure that everyone would know that the brain-storming of ideas would not be revealed until everyone was comfortable in signing off on the consensus reached on particular recommendations. The work product of our Group from its March 10 meeting, as well as earlier meetings that concern H.R. 833, is being prepared for circulation to the Group's members now, and we would anticipate sending your subcommittee another set of recommendations specifically addressing some of the major provisions of H.R. 833 within the next few days. A copy will, of course, be posted on ABI's website, *http://www.abiworld.org*, when it is sent to you.

Before addressing some comments to major changes proposed in bankruptcy law by H.R 833, it would be helpful to first explore how consumer bankruptcy operates under the current law.(see footnote 2) It is helpful to look at current bankruptcy law as a two-part system that (1) determines the assets that are available to consumer debtors and (2) divides the assets, allowing the debtor to retain some of those assets, and using other assets to pay various of the debtor's creditors.

The assets available: All consumer debtors have the same two basic types of assets available to them: present assets and future assets. The present assets are what a debtor owns at the time a bankruptcy is filed. These include tangible assets like a home, a car, clothing, furniture, and cash, as well as intangible assets, like savings and retirement accounts and lawsuits for personal injury. Future assets are those to which a debtor first becomes entitled after a bankruptcy is filed. The principal future assets of most debtors are the personal earnings to which they become entitled after the bankruptcy filing; other future assets include gifts received or lawsuits accruing after the filing.

Page 49 PREV PAGE TOP OF DOC

The classes of claims: In a bankruptcy case, the assets available to the debtor are divided between the debtor and the debtor's creditors. The share of each creditor depends on the type of claim the creditor holds. The Bankruptcy Code sets out several different classes of claims:

(a) Secured claims. Debts that are supported by liens on property owned by the debtor (like a home mortgage, or a lien on an automobile) are known as "secured claims." The Bankruptcy Code generally provides that secured claims must be paid at least the value of the collateral that supports them before that collateral can be used by the debtor or paid to other creditors. In other words, the debtor and other creditors are only entitled to the "equity" that exists in the property above the amount of the claim for which the property is collateral. In this way, secured claims are generally

first in the distribution of a debtor's assets. Claims that are not supported by a lien on property of the debtor are known as "unsecured" claims.

(b) Priority claims. Certain claims are viewed by the Bankruptcy Code as being especially entitled to payment. Examples include certain tax obligations, expenses of administering a case in bankruptcy, and family support obligations of the debtor. Although these claims against the debtor may not be secured, the Bankruptcy Code provides that when a debtor's assets are distributed, these claims should be paid ahead of other unsecured claims, and so they are known as "priority unsecured" or simply "priority" claims, in contrast to ordinary ("general") unsecured claims against the debtor.

(c) General unsecured claims. Unsecured claims that do not have priority status and "general unsecured" claims are involved in nearly every consumer bankruptcy case. Examples include most credit card debt and medical bills. However, even a creditor secured by a home mortgage or automobile lien may hold a general unsecured claim. An important concept in the Bankruptcy Code is that, whenever the value of collateral is insufficient to cover the entire amount owed on the creditor's claim, the creditor holding the lien has both a secured claim (to the extent of the collateral value) and an unsecured claim (in the amount of the deficiency in the value of the collateral). Thus, a creditor with a $10,000 claim, secured by an automobile worth only $7,000, is treated as having a secured claim of $7,000 and a general unsecured claim of $3,000.

Page 50 PREV PAGE TOP OF DOC

(d) Nondischargeable claims. Ordinarily, when the distribution of a debtor's assets under the Bankruptcy Code has been concluded, the debtor is given a discharge, wiping out the debts that the debtor owed at the time the bankruptcy was filed. Thus, all of the debtor's future assets, after the distribution, are allowed to be retained by the debtor. However, there is an exception to the discharge for certain types of debt. Some of this debt is of the same nature as priority debt (taxes and family support obligations), but the Bankruptcy Code also excepts from discharge certain debts that were incurred through misconduct of the debtor, such as debts arising from fraud and intentional injuries. These "nondischargeable" claims, to the extent they have not been paid from the assets that are distributed during a bankruptcy case, remain payable from the future assets of the debtor.

Chapter 7 bankruptcy: Distributing present assets to creditors. Since the enactment of the Bankruptcy Act of 1898, the standard process of a bankruptcy case has been for a trustee to collect the debtors' present assets, liquidate them, and divide the proceeds among the debtors' creditors, with the debtors, in exchange, being discharged from their debts, so that they retain the right to their future assets, free of claims of creditors. This process, set out in Chapter 7 of the current Bankruptcy Code, is known as "liquidation" or "straight bankruptcy." Allowing the debtors to use future assets free of creditor claims is known as the "fresh start."

There are, however, two features of Chapter 7 that vary the general plan of liquidating present assets for distribution to creditors and leaving future assets for the debtor. First, debtors are allowed to retain some of their present assets. The Bankruptcy Code sets forth a list of "exempt" property, deemed necessary for debtors' maintenance. States may provide an alternative to this list, and then either allow the debtors to choose between the two lists of exempt property (state and federal) or else provide that the state exemptions are the only ones available. In any event, debtors are allowed to keep some of their current assets as exempt, excluding them from distribution in Chapter 7. Where debtors have no substantial assets beyond those that are exempt, there will be no distribution to creditors. Cases such as these are known as "no asset" Chapter 7 cases.

Page 51 PREV PAGE TOP OF DOC

Second, debtors in Chapter 7 are not always discharged from all of their debts. As noted above, some debts are nondischargeable, and these remain, after bankruptcy, so that the creditors holding these claims may seek payment from future assets of the debtor. Moreover, under certain circumstances (generally involving misconduct by the debtor in the course of the bankruptcy itself), a Chapter 7 debtor may be denied a discharge altogether.

Taking all of this into consideration, Chapter 7 generally divides a debtor's assets as follows:

1. Secured creditors are given the value of their liens in the debtor's present assets.

2. The debtor's exemptions are deducted from the present assets.

3. Any remaining present assets are liquidated and distributed, first to priority claims, and then to general unsecured claims.

4. The debtor is given a discharge, allowing the debtor to have future assets free of creditor claims, subject to nondischargeable claims.

5. Nondischargeable claims remain payable in full from the future assets.

Chapter 13 bankruptcy: Distributing future assets to creditors. Chapter 13 is presented in the Bankruptcy Code as an alternative to the standard Chapter 7 liquidation. The basic idea of Chapter 13 is to allow debtors to retain all of their present assets, in exchange for paying to creditors, out of future assets, at least as much as the creditors would have received if there had been a Chapter 7 liquidation. To accomplish this, the debtor must propose a plan, administered by a trustee, to pay creditors through periodic contributions from the debtor's regular income. Chapter 13 recognizes that debtors cannot pay all of their income into the plan, since some income will be necessary for the support of the debtors and their dependents. However, all income not necessary for that support is defined as "disposable" income, and a Chapter 13 plan must either pay creditors in full, or devote all disposable income to the plan. A plan that does not provide for full payment of debts must have a duration of at least three years, and five years is the maximum length of the plan. Because of the disposable income requirement, it is possible for Chapter 13 plans to pay much more to creditors than they would have received in a Chapter 7 bankruptcy.

Page 52 PREV PAGE TOP OF DOC

Under current law, Chapter 13 is entirely voluntary. Only a debtor can propose a Chapter 13 plan; a debtor has an absolute right to dismiss a case that was originally filed under Chapter 13; and a debtor can convert a Chapter 13 case to Chapter 7 at any time. To encourage debtors to choose Chapter 13 over Chapter 7 (and thus provide greater payment to creditors), the Bankruptcy Code has two distinct types of incentives. First, at the conclusion of a Chapter 13 plan, the debtor is given a broader discharge than is available in Chapter 7. This "superdischarge" results in the discharge of several types of debt (including those for fraud and intentional injuries) that are not discharged in Chapter 7. Second, debtors are allowed to keep property that is encumbered by liens, even though they are in default on the underlying obligations. A debtor with a home in foreclosure or a car subject to repossession may be able to retain the home or car by making payments to the secured creditors through a Chapter 13 plan. Moreover, except for certain home mortgages, the debtor in Chapter 13 may pay to a secured creditor the value of the collateral, even though it is less than the full amount owing, and obtain a release of the lien. Chapter 13 contains detailed provisions as to the type of payments required on secured claims.

Plans in Chapter 13 are required to pay priority claims in full, over the course of the plan, and not to discriminate unfairly among general unsecured creditors. Considering all of its provisions, Chapter 13 generally divides a debtor's assets as follows:

1. The debtor retains all present assets.

2. The debtor contributes disposable future assets to a plan for a period of three to five years, or for a shorter period sufficient to pay the debts in full. The payments to be received by creditors must be at least as much as they would have received in a Chapter 7 case. Secured creditors must receive at least the value of their liens. Priority claims must be paid in full.

Page 53 PREV PAGE TOP OF DOC

3. The debtor retains all nondisposable future assets during the time of the plan.

4. After the completion of the plan, the debtor is given a discharge, allowing the debtor to retain all future assets, free of dischargeable creditor claims.

5. Nondischargeable claims remain payable in full from the future assets. However, many debts that are nondischargeable in Chapter 7 are able to be discharged in Chapter 13.

Choice of Chapter 7 or Chapter 13: Under current law, consumers have a largely free choice between Chapter 7 and Chapter 13 as a form of relief. However, there are some limitations, the most significant of which are the following: First, a debtor cannot file any bankruptcy case within 180 days after a prior case was dismissed under specified circumstances. Second, Chapter 13 is unavailable to individuals with large amounts of debt (over $269,250 in unsecured debt or $807,750 in secured debt). Third, a Chapter 7 case may be dismissed on motion of the court or the United States trustee if granting Chapter 7 relief would be a "substantial abuse." Fourth, a debtor cannot receive a discharge in a Chapter 7 case if that case was filed within six years of an earlier filing in which the debtor received a Chapter 7 discharge.

The automatic stay: In either Chapter 7 or Chapter 13, an automatic stay goes into effect at the time the case is filed, which generally operates to prohibit any collection activity, including foreclosure and repossession, on debts that were in existence at the time of the filing. In order to obtain the right to proceed with collection activity, a creditor must obtain relief from the automatic stay. In either Chapter 7 or Chapter 13, a creditor is entitled to relief if the value of its lien is declining or at risk of declining, and no action (known as "adequate protection") is taken to make up for the decline. In Chapter 7, the creditor is also entitled to relief if there is no equity in the property that might be obtained for the benefit of creditors. In Chapter 13, relief is granted if there is no equity and the property is not needed for the debtor's plan to be effective.

Page 54 PREV PAGE TOP OF DOC

Judge Eugene Wedoff has been posting on ABI's website a section-by-section analysis of the various bankruptcy reform bills pending before the Congress. He is at work on that analysis of H.R. 833. His preliminary analysis, containing some commentary on the major consumer proposals found in H.R. 833, follows:

1. MEANS TESTING—§101–102.

Content: Chapter 7 cases would be subject to dismissal or conversion to Chapter 13 (on the debtor's request), pursuant to §707(b), if the case would involve "abuse" of Chapter 7, instead of the "substantial abuse" now required. Motions would be required to be presented by the Chapter 7 trustee in many cases, and judicial discretion to deny the motions would be strictly limited.

Abuse under §707(b) would be presumed if, during a 5-year period, the debtor would have sufficient income to pay at least $5000 ($83.33 per month) toward general unsecured claims or to repay at least 25% of those claims. The debtor's ability to pay general unsecured claims would be calculated by deducting three categories of expenses from the debtor's current monthly income—defined on the basis of the debtor's average monthly income for 180 days prior to filing—(1) expenses allowed under IRS collection standards; (2) payments on secured claims that would become due during the 5-year period, divided by 60; and (3) all of the debtor's priority debt, again divided by 60.

The only way for a debtor to rebut the presumption of abuse would be to show "extraordinary circumstances that require additional expenses or adjustment of current monthly total income." Such a showing, in turn, would require detailed itemizations and explanations sworn to by both the debtor and the debtor's attorney. The extraordinary circumstances—together with the standard three deductions—would have to reduce the debtor's current monthly income to a level that would not allow payment of the minimum amounts of general unsecured claims (at least $5000 over 5 years, amounting to at least 25% of general unsecured claims).

Page 55 PREV PAGE TOP OF DOC

The Chapter 7 trustee would be required to analyze each case to determine whether the debtor's schedules reflected the presumptive ability to repay debt. If this analysis reflected grounds for a presumption of abuse under §707(b), the trustee would be required to file a §707(b) motion, unless the debtor's family income was less than a specified minimum (based on average household incomes).

Parties in interest would be allowed to bring §707(b) motions, but only in those circumstances where the trustee would be required to bring such motions. In cases where the debtor's income was below the specified minimum, only the judge, United States Trustee, bankruptcy administrator or case trustee could bring the motion.

Commentary: The major impact of this legislation is potentially to deny Chapter 7 relief to any debtor with $83.33 in disposable income per month, regardless of the amount of outstanding debt. For example, a debtor with bills totaling $200,000, and disposable income (under the formula) of $90 per month, would be found to have made an abusive Chapter 7 filing, even though less than 3% of the unsecured debt could be paid in a 5-year Chapter 13 plan. Conversely, debtors with very small amounts of disposable income could be denied Chapter 7 relief if their debts were also small. For example, a debtor with disposable income of only $20 per month could be denied Chapter 7 relief unless the unsecured debts scheduled exceeded $7200. There is a substantial advantage to basing means-testing on a fixed amount of disposable income rather than on an ability to repay a particular percentage of outstanding indebtedness—the debtor is not able to avoid §707(b) by accumulating greater indebtedness.

There are several problems with the use of the IRS standards in calculating disposable income. First, the IRS standards themselves include a category ("other necessary expenses") covering the sort of individualized expenses that also can be seen as arising from "extraordinary circumstances." The IRS standards do not specify any particular allowance for "other necessary expenses," and thus trustees would have to assess reasonableness on a case by case basis. If an expense arose from "extraordinary circumstances," rather than being in the category of "other necessary expenses," detailed scheduling (under oath from the debtor and the debtor's attorney) would be required. Trustees would therefore have to determine how any given expense not covered by the other IRS categories (such as costs of medical care) should be categorized.

Page 56 PREV PAGE TOP OF DOC

Second, secured debt presents a problem for calculating disposable income under the formula set out in the bill. The IRS expense allowances are intended to cover all housing and transportation expenses, including the cost of acquiring a dwelling or automobile. But because the bill's formula allows full repayment of secured debt in addition to the IRS allowances, debtors are given double expense allowances in all such situations. The bill therefore discriminates against those who rent either their housing or their automobiles. Such renters will receive only the expense allowance provided by the IRS standards (supplemented by any showing of extraordinary circumstances). Owners of cars or houses, in contrast, would receive not only the IRS allowance, but the full amount of their mortgage and auto loan payments as well, unlimited in amount.

Third, the fact that allowed expenses can be increased by incurring secured debt provides a strategy for avoiding the means test. For example, a debtor who would otherwise have disposable income of $400 per month could trade in an old car for a new one, with monthly payments of $350, and the resulting increase in secured indebtedness would reduce the disposable income to an amount that would not result in dismissal of the Chapter 7 case. Another method of avoiding the means test would be for a debtor to declare an intent to make charitable contributions. Section 4 of the Religious Liberty and Charitable Donation Protection Act of 1998 allows debtors to contribute up to 15% of their gross income to charity without those contributions being considered in making a determination under §707(b). Thus, a debtor with an income of $60,000 could remove $500 per month in disposable income by declaring an intent to make the maximum charitable contributions.

Alternatives: Instead of using IRS collection standards for assessing disposable income, means-testing might be based on data maintained by the Bureau of Labor Statistics. The BLS publishes annually a table of average consumer expenditures, grouped by income level. These tables would eliminate the confusion between "other necessary expenses" and expenses arising from "extraordinary circumstances." BLS figures might also be used to calculate presumptive maximums for acquiring housing and transportation, regardless of whether the housing or transportation is purchased with secured credit or rented. BLS categories could be incorporated into the schedules required to be completed by debtors, allowing for a simple determination by trustees as to the potential for abuse under §707(b).

Page 57 PREV PAGE TOP OF DOC

2. FUNDING PROSECUTION OF §707(B) MOTIONS—§101.

Content: Debtor's attorneys would be required to reimburse panel trustees for all costs of prosecuting a successful motion to dismiss or convert under §707(b) of the Code, wherever the court found the filing of the case "not substantially justified." If the court found a violation of Fed.R.Bankr.P. 9011, it would be required to impose a civil penalty against the debtor's attorney in favor of the United States Trustee or the case trustee. Costs could be imposed against the proponent of a §707(b) motion only if (1) the motion was not substantially justified, or (2) the motion was brought "solely for the purpose of coercing the debtor into waiving a right guaranteed . . . under the Bankruptcy Code," and (3) the moving party was not a panel trustee, the United States Trustee, or a party in interest with an aggregate claim against the estate of less than $1,000.

Commentary: It is desirable to provide some financial incentive for trustees to prosecute meritorious §707(b) motions. Under current law, if such a motion succeeds in having a Chapter 7 case dismissed, the trustee is likely to recover none of the costs of prosecuting the motion. However, offering the trustee a potential recovery from the debtor's attorney is problematic. The potential for an award of sanctions against debtors' counsel may have a chilling effect on representation of debtors—attorneys fearful of an award of fees may be unwilling to file even appropriate Chapter 7 cases. On the other hand, judges wary of this potential chilling effect may be unwilling to find that Chapter 7 cases were filed without substantial justification.

There is also a problem with the limitation of liability in cases of unsuccessful creditor motions under §707(b). The need for potential fee-shifting is due to the leverage that creditors would otherwise have to extract reaffirmation agreements from Chapter 7 debtors: a creditor could threaten a §707(b) motion unless its debt was reaffirmed, and the debtor, faced with the cost of responding to such a motion, might well accept reaffirmation as a less costly option, even if the debtor would be likely to prevail on the merits of the motion. The bill, however, eliminates potential creditor liability for creditors with claims of less than $1,000. Such creditors could therefore bring entirely groundless §707(b) motions without being liable to pay the costs of the debtor in responding. This immunization would allow major creditors to file §707(b) motions, without potential liability, in any case where their claims were small.

Page 58 PREV PAGE TOP OF DOC

Alternatives: The trustee's recovery in the event of unjustified Chapter 7 filings could be limited to an automatic claim for fees and expenses against the debtor, rather than the debtor's attorney. (However, the court, in its discretion, would still be able to find that misconduct by the debtor's attorney merited an award under Rule 9011.) The award against the debtor could be in the form of a judgment, nondischargeable and entitled to priority in any later bankruptcy proceeding. Since the trustee would only prevail against debtor's with substantial disposable income, the likelihood of collection of such a judgment would be substantial enough to encourage trustees to prosecute appropriate §707(b) motions.

With trustees given an appropriate incentive to prosecute §707(b) motions, there would be no reason to insulate any creditor from potential fee shifting in the event that the creditor's motion was unsuccessful.

3. CHAPTER 13 PLAN LENGTH—§606.

Content: For debtors whose income equals or exceeds a specified amount, generally based on national median household income: (a) five years is the maximum term of the plan, (b) a plan cannot be amended to provide for payments extended beyond "the applicable commitment period under section 1325(b)(1)(B)(ii)," and (c) the "duration period" would be five years. For debtors whose income is below the specified amount, three years would be the maximum plan term unless the court found cause to extend the term to no more than five years (the current law as to all Chapter 13 debtors), and the "duration period" would be three years.

Commentary: The provisions of the bill are confused. There is no §1325(b)(1)(B)(ii) under current law, and the bill does not appear to add such a section. There is also no provision of the bill defining "duration period" or specifying its relevance. The provision regarding "duration period" is placed at the end of §1329 of the Code, which deals with plans modified after confirmation, and so would not appear to require a minimum five-year plan for any debtor. If the bill does require minimum five-year plans for certain debtors, it would make the completion of Chapter 13 plans more difficult for these debtors, increasing incidents of default, and giving the debtors an incentive to choose Chapter 7 over Chapter 13.

Page 59 PREV PAGE TOP OF DOC

Alternative: Current law, which has a three to five year duration for all Chapter 13 plans, may not require any change.

4. LIMITATION OF THE CHAPTER 13 DISCHARGE—§129, 807, 1113.

Content: All debts covered by §523(a)(1) (certain tax obligations), (a)(2) (fraud), (a)(3)(B) (unlisted debts requiring dischargeability determinations in bankruptcy court), and (a)(4) (breach of fiduciary duty) would be nondischargeable in Chapter 13 as well as in Chapter 7. All debts covered by §523(a)(6) would be remain nondischargeable only in Chapter 7. Property settlements in divorce and separation cases, treated by §523(a)(15) of the Code, would continue to be nondischargeable only in Chapter 7 cases, but whether such claims would be included in §523(a)(3)(B) in the event of untimely scheduling is an issue subject to conflicting provisions, discussed below at item 10.

Commentary: The "superdischarge" of Chapter 13 has the effect of encouraging debtors with debts that might be nondischargeable in Chapter 7 to choose Chapter 13 as a means of discharging those debts and obtaining a fresh start. This has the corollary result of reducing litigation over dischargeability. H.R. 833 would exclude from the Chapter 13 discharge debts arising from fraud—the most common ground for claims of nondischargeability, and the one involved in most claims of credit card nondischargeability—as well as certain tax claims, claims involving breach of fiduciary duty, and claims that were not scheduled in time to permit bankruptcy court adjudication of dischargeability. Under this change in the law, debtors subject to nondischargeability claims on any of these grounds would be encouraged to file under Chapter 7 rather than under Chapter 13. This would undercut one of the major purposes of the reform legislation—the encouragement of Chapter 13 repayment—and litigation over dischargeability in Chapter 13 would increase substantially.

Page 60 PREV PAGE TOP OF DOC

Alternative: To maintain the current incentive for debtors to file Chapter 13 cases, the current scope of the Chapter 13 discharge could be maintained. Situations of significant misconduct by debtors may be dealt with by requiring the bankruptcy court to give explicit consideration, in passing on the good faith of a Chapter 13 filing, to the existence of any debts that would be excepted from discharge in Chapter 7.

5. PRESUMPTION OF FRAUD—§135.

Content: All credit card debt aggregating more than $250 in cash advances or $250 in "luxury goods or services" during the 90 days preceding a voluntary bankruptcy filing would be presumed nondischargeable under §523(a)(2). "Luxury goods or services" is not defined, but the section specifies that the phrase "does not include goods or services reasonably necessary for the support or maintenance of the debtor or a dependent of the debtor."

Commentary: Under current law, there is a similar though less extensive presumption of fraud in the use of credit cards shortly before the filing of a bankruptcy case. A difficulty with applying this presumption—which is continued under H.R. 833—is that there is no specification of the elements of fraud as to which the presumption operates, and so there is no way to determine how the presumption can be overcome. Beyond this difficulty, the presumption of H.R. 833 is ambiguous in its use of the phrase "luxury goods or services." Although the bill clearly excludes "necessities" from the scope of "luxury goods," it leaves open the possibility that some purchases (like flowers for a spouse), although not "necessary" for support, would still be common enough, and inexpensive enough, not to be considered "luxuries." The absence of a definition here could lead to substantial litigation. Finally, the presumption in H.R. 833 aggregates all purchases and all cash advances. Thus, if several small "luxury" purchases were made from different creditors over a 90-day period, the bill would result in a presumption of fraud.

Page 61 PREV PAGE TOP OF DOC

Alternative: A distinct ground for nondischargeability could be defined for a debtor's use of a credit card without intending to pay the resulting debt. The law could specify that the debtor's financial situation would be relevant in determining this question of intent. Under this definition, a lack of intent to repay could be presumed for purchases of defined "luxuries" shortly before bankruptcy.

6. VALUATION OF SECURED CLAIMS—§124–125.

Content: Secured claims for the purchase of personal property acquired by an individual debtor within 5 years of the bankruptcy filing would not be bifurcated in any chapter of the Code. Where bifurcation did occur in Chapter 7 and 13 cases, the secured claim would be valued on the basis of the debtor's replacement cost, without deduction for costs of sale. For household and personal goods, this would be retail price.

Commentary: The overall impact of these provisions of H.R. 833 would be (1) to encourage debtors to surrender collateral in both Chapter 7 and 13 cases, and (2) to allow secured creditors to obtain higher payments in Chapter 13 than under current law, at the expense of unsecured creditors.

Surrender of collateral would be encouraged, because, unless the debtor purchased the collateral more than five years prior to the bankruptcy, the debtor would have to pay the full amount outstanding on the purchase in order to retain the collateral, even if the collateral was worth much less that the outstanding balance. For example, the debtor may have purchased a used car, or a new refrigerator, on credit, with a high rate of interest. If the debtor missed several payments before filing the bankruptcy case, the amount owed on the car or refrigerator could greatly exceed its actual value. Nevertheless, in order to redeem the property in Chapter 7 or to retain it in Chapter 13, §124 of the bill would require the debtor to pay the full outstanding balance. In such circumstances, it would often be in the debtor's best interest to return the collateral, and attempt to purchase a replacement. It can be anticipated that "bankruptcy financiers" would make credit available to enable the purchase of such replacements.

Page 62 PREV PAGE TOP OF DOC

Where the debtor did choose to retain property in Chapter 13, unsecured creditors would be disadvantaged (compared to their treatment under current law) in any case that did not have a 100% payout. This is because, under current law, secured creditors are paid only the value of their collateral (with interest). The plan payments of the debtor in excess of this collateral value are paid on account of unsecured claims—including the claims of secured creditors in excess of the value of their collateral.

Valuing collateral at its retail price involves payment to secured creditors of more than they could obtain upon surrender or repossession of the collateral (since selling the property at retail would ordinarily involve substantial costs of sale). This provision, then, would also have the effect of diverting funds from unsecured to secured creditors in many Chapter 13 cases.

Alternative: Certain types of secured credit may be of sufficient economic impact that full repayment of the indebtedness should be protected in bankruptcy. Certain home mortgages are given such protection under current bankruptcy law (pursuant to §1322(b)(2) of the Code). This sort of protection could be extended to other defined types of secured lending, certain auto loans for example, without making major changes in the general treatment of secured claims in bankruptcy.

7. ADEQUATE PROTECTION OF SECURED CLAIMS PENDING CHAPTER 13 PLAN CONFIRMATION—§137.

Content: Payments of adequate protection would be required, pending confirmation of a Chapter 13 plan, at times and in amounts specified by the applicable contract, but the debtor would be allowed to seek a court order reducing the amounts and frequency.

Page 63 PREV PAGE TOP OF DOC

Commentary: By requiring adequate protection payments to be made in addition to preconfirmation plan payments, this provision would make Chapter 13 very difficult for many debtors. Plan payments are often intended to deal with secured claims, and are often required to exhaust the debtor's disposable income (pursuant to §1325(b) of the Code). Thus, pending confirmation, it would often be impossible for debtors to make both plan payments (as required by §1326 of the Code) and adequate protection payments. Furthermore, contract payments are often in an amount greater than the depreciation of collateral withheld by the debtor, and so a presumption that adequate protection should be paid in the contract amount may be unreasonable. Requiring the debtor to seek a lower payment would increase the debtor's costs of proceeding in Chapter 13.

Alternative: Chapter 13 trustees could be required, pending confirmation, to make payments to secured creditors of the payments that these creditors would receive under the debtor's proposed plan. If these payments are insufficient to provide adequate protection, the court could be authorized to increase the payments on the creditor's motion or—if this were not possible—to dismiss the case.

8. TIMING OF EVENTS IN CHAPTER 13 CASES—§605.

Content: Debtors would be given 90 days after case filing to file a Chapter 13 plan; no change is made in the time for meetings of creditors, which (under Fed.R.Bankr.P. 2003(a)) requires that the meeting take place between 20 and 50 days after case filing; confirmation hearings would be held between 20 and 45 days after the meeting of creditors.

Page 64 PREV PAGE TOP OF DOC

Commentary: The timing specified by H.R. 833 would cause substantial difficulty. Current bankruptcy law, Fed.R.Bankr.P. 3015, requires the debtor to file a Chapter 13 plan within 15 days of the case filing. By delaying plan filing for up to 90 days after case filing, the bill would allow plans to be filed after the time set for the meeting of creditors under §341, which would then have to be continued. The notice of the meeting of creditors would be issued prior to filing of the plan, and so would not be able to include any information about the plan, thus requiring a separate notice or resulting in inadequate information for creditors prior to the meeting. If the meeting of creditors is continued, a question will arise about whether the confirmation hearing must be held within 45 days of the first date set for the meeting, or whether that time limit should run from the continued date. Any delay in confirmation, which would be often necessitated by the proposed procedure, would result in a delay in payment of unsecured creditors, and greater need for litigation regarding adequate protection payments to secured creditors pending plan confirmation.

Alternative: The current 15 day deadline for plan confirmation could be set out in the statute.

9. SPECIAL TREATMENT FOR SUPPORT OBLIGATIONS—§141–144, 146–147.

Content: Several provisions of H.R. 833 extend special treatment to a category of claims know as "domestic support obligations." These claims would be defined to include obligations arising both before and after the filing of the bankruptcy case, whether owed to a spouse, former spouse, child, or guardian of the child of the debtor, or to any governmental entity, as long as the obligation both was in the nature of support and arose from a specified agreement, decree, or process. The special treatment would include the following:

Page 65 PREV PAGE TOP OF DOC

"Domestic support obligations" would be accorded the first priority of distribution.

"Domestic support obligations" would be required to be current as a condition for confirmation of any plan under Chapter 11 or 13.

The automatic stay would not apply to actions in connection with "domestic support obligations," and all such obligations would be excepted from discharge pursuant to §523(a)(5).

Exempted property would continue to be liable for domestic support obligations, under §522(c)(1), even if state law provided to the contrary.

Payment of domestic support obligations would be excepted from preference recoveries, pursuant to §547(c)(7).

Commentary: The only one of the new protections that makes a major change in current law is the first priority for support obligations. This provision would give support obligations priority over administrative expenses. As a result, trustees may have to decline to administer many cases involving support obligations. In order to recover funds in such cases, the trustee would often have to retain professionals, and these professionals could only be paid after the support obligations were paid in full. To avoid situations in which assets were recovered by the efforts of professionals and the professionals were left unpaid, trustees would choose not to pursue the recoveries. This would have the effect of reducing payments of support obligations in bankruptcy.

Page 66 PREV PAGE TOP OF DOC

Alternative: Support obligations should have a priority subordinate to administrative expenses.

10. NONDISCHARGEABILITY OF PROPERTY DIVISIONS—§145, 1113.

Content: H.R. 833 contains conflicting provisions on this topic. Section 145 makes all property settlements in family cases nondischargeable pursuant to §523(a)(15), regardless of ability and need, and removes exclusive bankruptcy jurisdiction, so that claims covered by §523(a)(15) would not require timely adjudication in bankruptcy court. In contrast, §1113 generally reaffirms the current language of §523(a)(15), and implicitly continues exclusive bankruptcy jurisdiction over §523(a)(15) by providing that, if a creditor does not receive notice of the bankruptcy in time to obtain bankruptcy court adjudication under §523(a)(15), the claim would be nondischargeable under §523(a)(3)(B).

Commentary: If H.R. 833 were enacted in its present form, the conflicting provisions as to §523(a)(15) would lead to substantial uncertainty and unnecessary litigation.

Alternative: Retention of the present law (as set out in §1113 of H.R. 833) may be the better alternative. There is no apparent reason why property settlements not needed for support should be made nondischargeable. For example, a wealthy nondebtor spouse may have been awarded a right to payments offsetting the debtor's retention of a retirement account. If, after the divorce, the debtor's financial condition has deteriorated, and the debtor has difficulty meeting ordinary living expenses, it is difficult to see why the nondebtor spouse should be able to enforce a nondischargeable claim for the property settlement payments.

Page 67 PREV PAGE TOP OF DOC

11. DISCLOSURE OF TAX RETURN INFORMATION—§603–604.

Content: Several items—including copies of all federal tax returns, with schedules and attachments, filed by the debtor during three years prior to the bankruptcy case—would be added to the information that individual Chapter 7 and 13 debtors are required to provide, unless otherwise ordered by the court. These documents would be available for inspection and copying by any party in interest, but the Director of the Administrative Office of the United States Courts would be required to "establish procedures for safeguarding the confidentiality of any tax information." If the required information were not filed within 45 days of case commencement, the case would automatically be dismissed. However, the court could authorize an extension of the period for filing for up to 45 days.

Commentary: There are several problems with these provisions: (1) the requirement to furnish tax returns (and the other required information) would impose an additional cost on debtors who do not have tax return copies and financial records available; (2) the requirement to file tax returns will impose additional costs in personnel and storage on the clerks of the bankruptcy courts; (3) automatic dismissal would take place even in cases where the trustee finds assets to administer, such as preferences and fraudulent conveyances, that creditors might have difficulty pursuing outside of bankruptcy; (4) it would be difficult for regulations to safeguard the confidentiality of tax returns in a manner consistent with the general requirement that they be made available to any party in interest for inspection and copying.

Alternative: If tax return information is to be kept confidential, it should not be part of the public bankruptcy files, and should not be made available to creditors for inspection and copying. However, tax return information could be required to be presented to the bankruptcy trustee (in either Chapter 7 or Chapter 13) prior to the meeting of creditors. The information could be ordered to be submitted in electronic form, as maintained by the Internal Revenue Service, and actual copies of returns could be required to be produced upon the trustee's request. Other parties, including creditors, would continue to be able to obtain tax return information on motion, pursuant to Fed.R.Bankr.P. 2004.

Page 68 PREV PAGE TOP OF DOC

12. AUDITS—§602.

Content: Audits would be required in at least 0.4% of individual Chapter 7 and 13 cases, as well as schedules reflecting "greater than average variances from the statistical norm of the district in which the schedules were filed." The audits would be required to be performed "in accordance with generally accepted auditing standards [GAAS] . . . by independent certified public accountants or independent licensed public accountants." The U.S. trustee for each district would be authorized to contract for the auditing services, but no funds are provided for this purpose.

Commentary: The principal problem with this provision is its cost. Audits by licensed professionals according to GAAS are likely to be very expensive, and such formal audits are likely unnecessary to determine significant misstatements in debtors' petitions and schedules. Moreover, the provision is ambiguous in requiring audits of all schedules with "greater than average variances from the statistical norm of the district in which the schedules were filed." The provision does not indicate the items as to which variance from the norm should be measured. However, likely items would include income and expenses, but assets and claims may be intended as well. If "statistical norm" means the median, and the average variation is the midpoint between the high and low points and the median, then the proposal could require audits of half of all schedules on each of the relevant items: for example, those schedules reflecting the lowest 25% and the highest 25% of income.

Alternative: In order to reduce costs, audits could be conducted by trained employees of the United States trustees, rather than by licensed accountants, according to regulations established by the Executive Office of the United States Trustee, rather than generally accepted auditing standards. A lower minimum number of cases could be subject to audit, with provision that the United States trustees would be authorized, in their discretion, to conduct audits of cases referred to them by Chapter 7 and 13 trustees.

Page 69 PREV PAGE TOP OF DOC

13. CREDIT COUNSELING—§302.

Content: Individuals would generally be ineligible for bankruptcy relief under any chapter of the Bankruptcy Code, pursuant to §109, until they had first attempted to negotiate a voluntary repayment plan through a consumer credit counseling service approved by the United States trustee, with no limitations as to the type of counseling service that could be approved, as long as the service provided (1) an individual or group briefing outlining opportunities for available credit counseling and (2) assistance in performing an initial budget analysis. Exceptions would be made for situations (1) in which the U.S. trustee or bankruptcy administrator found that credit counseling services were unavailable and (2) in which the debtor was unable to obtain credit counseling services within five days of making a request from an approved counselor. Any party would be allowed to bring a motion to dismiss based on the debtor's ineligibility under this section.

Commentary: The eligibility requirement would add to the cost of bankruptcy relief. If an individual is in genuine need of bankruptcy relief, and consults an attorney for that purpose, the attorney would have to direct the individual to a credit counseling service for briefing and budget analysis before the bankruptcy case could be filed. The attorney would then have to conduct another budget analysis in order to prepare the bankruptcy schedules. Existing counseling services would be burdened by the need to brief and counsel individuals who have no likelihood of being able to pay their debts through a voluntary repayment plan. Debtors in need of immediate bankruptcy relief to avoid foreclosure, repossession, eviction, or wage garnishment would be unable to obtain timely relief if immediate consumer counseling were unavailable. Accordingly, it can be anticipated that counseling services would be created that would work in conjunction with debtors' attorneys in providing immediate counseling. Regulating and approving credit counselors would impose a substantial burden on the U.S. trustees.

Page 70 PREV PAGE TOP OF DOC

Alternative: Two changes to the provision on credit counseling would likely have a significant beneficial impact. First, the requirement for credit counseling could be applicable only in Chapter 7 cases. Chapter 13 cases already incorporate the essential features of voluntary repayment plans—careful budgeting, living within the budget, and payment of all disposable income to creditors. Eliminating the cost, expenditure of time, and delay involved in separate credit counseling would encourage use of Chapter 13. Second, the debtor could be allowed to complete the required counseling after the filing of a bankruptcy case upon a showing that the filing was necessary to avoid foreclosure, repossession or wage garnishment. In such situations, the filing fee could be deferred until after the debtor completed the credit counseling, so that, if the debtor elected to pursue a voluntary repayment plan outside of bankruptcy, the bankruptcy case could be dismissed without payment of a fee.

14. DEBTOR EDUCATION—§104, 302.

Content: First, the Executive Office of the U.S. Trustee would be required (1) to develop a program to educate debtors on the management of their finances, (2) to test the program for one year in three judicial districts, (3) to evaluate the effectiveness of the program during that period, and (4) to submit a report of the evaluation to Congress within three months of the conclusion of the evaluation. The test program would be made available, on request, to both Chapter 7 and 13 debtors, and, in the test districts, bankruptcy courts could require financial management training as a condition to discharge.

Second, a new exception to discharge would be applicable in Chapter 7 cases, for situations in which the debtor failed to complete a course in personal financial management administered or approved by the U.S. trustee. Similarly, the court would be directed not to grant a Chapter 13 discharge to any debtor who failed to complete such a course. An exception would be made for districts in which the U.S. trustee or bankruptcy administrator found that suitable courses were unavailable.

Page 71 PREV PAGE TOP OF DOC

Commentary: These provisions raise several difficulties: (1) the education requirement would apply to individuals who could not benefit from such a course, such as financially responsible individuals who had encountered financial problems unconnected to failures in personal budgeting; (2) there is no provision for payment for such courses, and Chapter 13 debtors would ordinarily lack disposable income to pay for them; (3) substantial resources would have to be expended by the U.S. trustee in order to administer a program for approving and regulating educational facilities; (4) it would be premature for the United States trustee to administer or approve programs for debtor education prior to completion of the pilot educational programs; (5) if discharge is denied to individuals who do not complete educational programs in the pilot districts, but no such requirement is imposed in other districts, there will be a substantial constitutional question raised under the uniformity provision of the Bankruptcy Clause (see *Railway Labor Executives Ass'n* v. *Gibbons*, 455 U.S. 457, 466, 102 S.Ct. 1169, 1175, 71 L.Ed.2d 335 (1982), for a discussion of the uniformity clause).

Alternative: Debtor education is likely to be far more effective in Chapter 13 than in Chapter 7 cases. Debtors in Chapter 7 cases generally come in contact with the bankruptcy system only at a brief meeting of creditors and are thereafter promptly discharged. Chapter 13 debtors, in contrast, usually maintain a long-term relationship with the Chapter 13 trustee. Several Chapter 13 trustees have been conducting programs of debtor education for several years. Based on these programs, programs of voluntary debtor education could be implemented in a large number of judicial districts, as part of the Chapter 13 trustees' operating budget. Based on the results of this study, an educational program could be made mandatory, perhaps limited to particular situations in which the education is likely to be helpful. In Chapter 7 cases, any educational effort might be limited to a group presentation at the creditors' meeting. Such presentations could also be conducted on a voluntary basis in pilot districts to measure their effectiveness before being made mandatory.

Page 72 PREV PAGE TOP OF DOC

15. HOMESTEAD EXEMPTIONS—§126.

Content: Debtors would be required to reside in a state for 730 days before being allowed to claim the exemption law of that state.

Commentary: The proposal would not address abuse of the bankruptcy system by existing residents of states with unlimited homestead exemptions. Such individuals may amass substantial estates in homestead property, and obtain a bankruptcy discharge without surrendering any of that property. The proposal would discourage some debtors from changing their state of domicile for the purpose of obtaining higher exemptions. However, it would encourage many others to make such changes. Since no state's exemption law would apply until a debtor had resided in the state for two years, the applicable exemption law would be the federal exemptions. These exemptions are more generous than the laws of many states, and debtors from states with exemptions lower than the federal exemptions would be encouraged to move to any new state prior to filing bankruptcy.

Alternatives: Two different alternatives might address problems in connection with homestead exemptions. First, a cap might be placed on the homestead exemptions available in bankruptcy, together with a provision that the cap would not apply in the case of involuntary bankruptcy cases. This would reduce (to the level of the cap), the most flagrant abuses of the homestead exemption. Second, in situations of changes of domicile, the law could provide that, for a specified period after a change of domicile, debtors would only be allowed to apply to their homestead the exemption law of the state of domicile with the lower homestead exemption.

Page 73 PREV PAGE TOP OF DOC

16. BANKRUPTCY APPEALS—NOT TREATED IN H.R. 833.

Commentary: Although both H.R. 3150 and S. 1301, passed by their respective houses in 1998, contained provisions for expedited appeals from bankruptcy courts to the circuit courts of appeal, the Conference Report on the bills, and hence H.R. 833, fail to address the issue. Direct appeal would have the benefit of reducing the cost of obtaining binding precedent in bankruptcy cases, and hence increase uniformity and certainty in the application of bankruptcy law, reducing unnecessary litigation.

Alternative: The principal concern about expedited consideration of bankruptcy appeals is the burden that this would place on the circuit courts. This concern could be alleviated by providing a system such as the following: (1) all appeals from bankruptcy courts would be heard by bankruptcy appellate panels, (2) bankruptcy appellate panels would serve as units of the circuit courts, (3) decisions of bankruptcy appellate panels would be decisions of the circuit court unless any judge of that court directed further consideration, and (4) upon such direction by a judge of the circuit court a panel of three judges of the circuit court would direct such further briefing and argument as the panel found necessary prior to rendering a further decision.

17. EFFECTIVE DATE—§1201.

Content: Unless otherwise specifically provided, the amendments would become effective 180 days after enactment, and would not apply to cases pending on that date.

Page 74 PREV PAGE TOP OF DOC

Commentary: Because of the many changes in the law, a delay in the effective date would be critical to allow for study and preparation of forms and procedures necessary to comply with the new provisions.

I, Judge Wedoff, and the ABI will continue to be available to this committee and the Congress to contribute whatever would be of help in your work on bankruptcy reform legislation.

Mr. **GEKAS.** And now we acknowledge for the record the attendance of the gentleman from New York, Mr. Weiner. And, with that, we turn to Professor Zywicki.

STATEMENT OF TODD ZYWICKI, PROFESSOR, GEORGE MASON UNIVERSITY SCHOOL OF LAW, ARLINGTON, VA

Mr. **ZYWICKI.** It is an honor to appear before the subcommittee and an honor to be on such a distinguished panel of participants.

There has been a lot of talk over these hearings about the causes of bankruptcy, and I will get to that in a second. But I at first want to call to everybody's attention that why filings are up it is largely irrelevant to this bill. This bill is not punitive. It does not deny the right to anybody to file bankruptcy or the ability to file bankruptcy.

Means testing is aimed not at punishing people for filing bankruptcy, means testing is aimed at restoring fairness, uniformity and confidence, public confidence, in the bankruptcy system, protect creditors from losses that could be avoided, save all of us from the losses that are passed on from opportunistic bankruptcy filings; and it makes a moral statement that we take bankruptcy seriously and the promises should be kept to the extent that people can keep their promises. That is all means testing does.

Page 75 PREV PAGE TOP OF DOC

It is irrelevant why people are filing bankruptcy. All it says is that if you have the money to repay a substantial portion of your debts without significant hardship, you should do so.

It is also an improvement over current section 707(b), which is an absolute joke and a complete disaster.

I have called in my statement attention to this case, *In Re Attanasio*, which literally surveys 200 to 300 cases applying section 707(b) in various different ways. There is no uniformity about how it is applied. It spawns litigation. It creates complete chaos and a completion perception that the bankruptcy is unfair and arbitrary.

Similarly, there has been a lot of talk about the general chapter 13 failure rate and pushing people into chapter 13. The general chapter 13 failure rate is a completely different situation from what we are dealing with here. The general chapter 13 failure—people file chapter 13 for a lot of reasons. Sometimes it is just to try to work out something with the bank on their home mortgage. Sometimes it is an attempt to get the superdischarge of chapter 13.

Those people are not people who are affected by means testing. They are not the kind of people who are targeted by means testing. Means testing targets high-income debtors who have steady incomes and can afford to repay a lot of their debts over time. The general chapter 13 failure rate is a completely different scenario from what is covered by this bill.

Page 76 PREV PAGE TOP OF DOC

Now, does that mean that the general causes of bankruptcy are irrelevant? No. Because once we understand the general causes of bankruptcy, we will see that reform is even more pressing than it appears today.

First, what is driving this upward spiral in the filing rate? Well, first there has been a general change in the costs and benefits associated with filing bankruptcy. The benefits of bankruptcy are obvious, especially chapter 7. It protects assets through exemptions, stops creditor collection efforts.

Michelle White, an economist at the University of Michigan, estimates that 15 to 20 percent of Americans with decent bankruptcy planning would come out ahead in the game if they filed bankruptcy under the current system, filing chapter 7, loading up on their exemptions and passing through the bankruptcy.

But, by contrast, the costs of bankruptcy have fallen significantly. Search costs—what economists call search costs have fallen substantially. Advertising is everywhere. A huge number of celebrity bankruptcies has essentially created the greatest free advertising that you could imagine for the bankruptcy system.

When singer Toni Braxton filed bankruptcy, a reporter asked, what are you going to do now? She said, I am going to go out and enjoy myself. She has a Lexus and a Porsche and sold 17 million in records.

The water cooler effect is also an important thing—people learning from each other. But, most importantly, what is driving this is a demise in the personal shame, social stigma associated with filing bankruptcy. Four studies in approximately the past year have found that the loss of personal shame and social stigma is what is driving bankruptcy filings; and, in particular, it is driving it for the high-income debtors who are targeted by this bill. Why? Because the financial benefits of filing bankruptcy are greatest for the high-income debtors who can protect money in these exemptions, who can hire good lawyers to engage in bankruptcy planning; and it has been traditionally the shame and stigma associated with filing bankruptcy that has restrained high-income debtors more than anybody else.

Page 77 PREV PAGE TOP OF DOC

As the shame and stigma continues to decrease, to paraphrase Senator Moynihan, as we define bankruptcy deviancy downward, what we are going to see is an increasing number of high-income debtors in the system.

If I may just finish up, and I hope that we will address this more in the questions, but there are a number of false explanations floating around for what is driving this. In particular, it is this myth that debt drives bankruptcy. That is untrue. I hope we will get to explore that more in the questions.

Even more improper is the argument that credit cards—that somehow credit card debt is driving bankruptcy. That is untrue also.

Regrettably and finally, unemployment, health care, those sorts of things, simply can't explain 20 percent increases in bankruptcy filing rates that we have seen in recent years. We have not seen 29 percent increases in debt. We have seen 29 percent increases in bankruptcy filing rates. So I hope that we will get to explore those more in the questions.

Mr. **GEKAS.** We thank the gentleman. The time of the gentleman has expired.

[The prepared statement of Mr. Zywicki follows:]

PREPARED STATEMENT OF TODD ZYWICKI, PROFESSOR, GEORGE MASON UNIVERSITY SCHOOL OF LAW, ARLINGTON, VA

Page 78 PREV PAGE TOP OF DOC

BIO

Professor Todd J. Zywicki teaches Bankruptcy, Contracts, and Commercial Law courses at George Mason University School of Law in Arlington, VA, where he has been an Assistant Professor of Law since 1998. Prior to joining the faculty at George Mason, he was an Assistant Professor of Law at Mississippi College School of Law in Jackson, MS from 1996–1998. Prior to that, Professor Zywicki clerked for the Honorable Judge Jerry E. Smith on the United States Court of Appeals for the Fifth Circuit, and practiced bankruptcy law with Alston & Bird in Atlanta, GA. He received his J.D. from the University of Virginia in 1993, a Master's Degree in Economics from Clemson University in 1990, and his undergraduate degree cum laude with distinction in his major from Dartmouth College in 1988. Professor Zywicki is the author of over 20 published articles, essays, and book reviews in both law reviews and economics journals. He has written widely in the areas of bankruptcy, environmental law, constitutional law, constitutional history, and economic analysis of law. Professor Zywicki is also a Contributing Editor to the *Norton Bankruptcy Treatise* and Co-Chair of the Bankruptcy Subcommittee of the Federalist Society's Financial Institutions Practice Group. He has previously testified on bankruptcy issues before the United States Senate, Judiciary Committee, Subcommittee on Administrative Oversight and the Courts and the United States House of Representatives, Judiciary Committee, Subcommittee on Commercial and Administrative Law. Recent publications on bankruptcy law include, "It's Time for Means-Testing" (co-authored with Judge Edith H. Jones), 1999 *BYU L. Rev.* (forthcoming 1999); "Rewrite the Bankruptcy Laws, Not the Scriptures: Protecting a Bankruptcy Debtor's Right to Tithe," 1998 *Wisconsin L. Rev.* 1223; "Mend It, Don't End It: The Case for Retaining the Disinterestedness Requirement for Debtor in Possession's Professionals," 18 *Mississippi College L. Rev.* 291 (1998).

Page 79 PREV PAGE TOP OF DOC

STATEMENT

It is a pleasure and an honor to testify before this Subcommittee today on the topic of Perspectives on Consumer Bankruptcy Reform. I have practiced, taught, and published articles on the subject of consumer bankruptcy. Most recently I am a co-author with Judge Edith H. Jones of the forthcoming article, "It's Time for Means-Testing," which will be published in the B.Y.U. Law Review, a copy of which Judge Jones and I have previously inserted into the record of the Hearings on the Bankruptcy Reform Act of 1999. I am also the author of a working paper on "Credit Cards in Bankruptcy."

The current state of the consumer bankruptcy system has been well-documented. Year after year, consumer bankruptcy filing rates spiral upward at record rates to reach all-time highs, even as unemployment, interest rates, inflation, and business bankruptcies plunge downward to record lows. The need for consumer bankruptcy reform is pressing. The Bankruptcy Reform Act of 1999 (the "Act") is a strong step in the right direction.

The central provision of the Act as it relates to consumer bankruptcy is the creation of a "means-test" for high-income debtors. As I noted in my prior testimony, *see* Statement of Todd J. Zywicki, March 11, 1999, the debate over means-testing boils down to a simple question: Should high-income debtors, who can repay a substantial portion of their debts without significant financial or other hardship, be required to do so?

Clearly, the answer to this question is "yes," for the reasons I have previously stated. To summarize, means-testing would have no impact whatsoever on poor individuals and families. It would have no impact on those suffering chronic health problems that prevent them from maintaining a steady job. In short, it would have no impact at all on those who need bankruptcy the most: the poor, unemployed, and unfortunate debtors who comprise the bulk of the bankruptcy system. Thus, claims that "means-testing is mean-spirited," not only are unfounded, but appear to lack an understanding of the means-testing provisions contained in the Act.

Page 80 PREV PAGE TOP OF DOC

Although means-testing leaves low-income debtors unaffected, it identifies a discrete and well-defined class of high-income debtors who have the ability to repay a substantial portion of their debts without significant financial or other hardship. Estimates vary, but it appears that only 10% or less of bankruptcy filers would be subject to means-testing. But because means-testing targets high-income debtors with a substantial ability to repay, those debtors could repay 60%–70% of their debts, which amounts to a total of over $4 billion. Thus, even if adopting means-testing would increase administrative costs (an erroneous conclusion, as will be discussed in a moment), it would do so only by $100–$200 million—a figure that is dwarfed by the financial recoveries enabled by means-testing. Establishing a statutory means-testing rule also would bring needed uniformity, predictability, fairness, and confidence to the consumer bankruptcy system. Finally, means-testing would send the crucial moral signal that bankruptcy is a serious matter, and should not be used simply to abandon promises that one has the capacity to keep and debts that one has the ability to repay.

The current system of policing abuse under §707(b)'s "substantial abuse" provision has spawned a cottage industry in trying to articulate coherent, consistent, and fair standards for enforcing this maddeningly vague command. This has led to very high rates of litigation and unpredictability. The confusion of trying to interpret current §707(b) is summarized in the case of *In re Attanasio*, 218 B.R. 180 (Bankr. N.D. Alabama 1998). In that case, Judge Cohen discusses literally hundreds of different cases interpreting §707(b), all of which apply different legal rules and weigh the facts differently. Surveyed cases seem to run from finding substantial abuse when a debtor has the ability to repay 17% of their unsecured debts over a period of 36 months in one case, to 19% over 36 months or 31.7% over 60 months, to cases requiring 54%, or 90%, or 100%. There is no agreement as to how much the debtor has to have the ability to pay, nor is there any guidance as to whether the relevant period of examination is 36, 48, or 60 months. And all this confusion is just over drawing the line as to how much the debtor must be able to repay to constitute substantial abuse. Similar confusion reigns over what level of income the debtor must have to have the ability to repay. On this point, Judge Cohen surveys roughly 200 or 300 more cases that run from as much as $19,000 per month in income down to $500 per month. From there, the case goes on page after page, case after case, discussing the standards, factors, and weightings that various courts have engaged in to determine whether there is substantial abuse in any given case. And, of course, often these decisions are not final, as appeals to the district court and beyond often will follow.

Page 81 PREV PAGE TOP OF DOC

In contrast to the current system, the means-testing provisions supplied by the Act will streamline the system and limit the issues in a given case to a narrow and discrete inquiry. The bottom 80% of cases will not even be impacted by means-testing, as they will not even meet the minimum income threshold. Similarly, the very top income earners will almost certainly be impacted by means-testing, so there will be little litigation in those cases. Indeed, many of those who can repay all or almost all of their debts will simply choose to forgo bankruptcy altogether, thereby removing those cases from the system completely. Unlike the wide-ranging legal and factual inquiry required by the current system, as exemplified by the *Attanasio* case, means-testing will focus inquiry on a relatively small group of cases who will be borderline candidates, as most filers will be clearly affected or clearly unaffected. And for this borderline group, the inquiry will be far more narrowly and specifically tailored than under the current regime. Thus, litigation should go down under means-testing, not up. Decisions will be more predictable and uniform. And not only will the actual fairness of the consumer bankruptcy system be enhanced, but so will the perception of fairness in the eyes of the public, leading to increased confidence in the consumer bankruptcy system.

Finally, the costs of bankruptcy reform must be weighed against the costs associated with *not* reforming the bankruptcy system. If current trends continue, bankruptcy filing rates will continue to escalate. This will lead to a need for more judges, more trustees, and more administrative costs for everyone. Thus, to the extent that bankruptcy reform slows filing rates, it will be an improvement over the trends predicted if bankruptcy reform is abandoned.

It is also misguided to point to evidence of the high failure rate for Chapter 13 cases to undercut means-testing. Standing alone, Chapter 13 failure rates are inapposite to the debate over means-testing, as they reflect numerous factors that have little relevance to the current debate. First, a huge number of Chapter 13 cases are filed not because the debtor expects or desires to maximize the payout to her creditors, but to stay a mortgage foreclosure and to pay off any arrearages. Once that task is completed, the case is often converted to Chapter 7, but it goes in the books as a Chapter 13 "failure." *See In re Kornfield*, 211 B.R. at 475. Second, many debtors simply should not be in Chapter 13 in the first place, in that they lack sufficiently regular income-earning patterns to make it feasible for them to complete a Chapter 13 plan. These debtors file Chapter 13 for a variety of reasons, including a desire to gain its superdischarge, overoptimism about the ability to complete a plan, or mistake. Of course, those impacted by means-testing will by definition be upper-income individuals with regular earnings, hence they should have much higher success rates than the typical Chapter 13 case. Thus, one should not be misled by the general failure rate of Chapter 13 cases into thinking that this may be an accurate prediction of the likely result of the group of Chapter 13 cases created by means-testing.

Page 82 PREV PAGE TOP OF DOC

Understanding the Bankruptcy Boom

As a nation of entrepreneurs, risk-takers, and immigrants looking for a fresh start on life, the United States has long had a history of generous and forgiving bankruptcy laws. To this day, our bankruptcy laws are among the most forgiving in the world. But the availability of generous and forgiving bankruptcy laws was always counterbalanced by a strong ethic of personal responsibility and respect for promises and contracts. This traditional attitude was personified by Harry Truman, who was confronted by large debts arising from the failure of his Kansas City haberdashery during the 1921 recession that rocked the agricultural Midwest. Rather than file bankruptcy, Truman vowed to pay off his debts. As David McCullough wrote in his biography of Truman, "Fifteen years after the store went under, Harry would still be paying off on the haberdashery, and as a consequence would be strapped for money for twenty years." But he did, even after his partner filed bankruptcy himself.

Perhaps the modern view is best personified by Dr. Robert N. Kornfield. *See In re Kornfield*, 164 F.3d 778 (2d Cir. 1999). Dr. Kornfield is a gastroenterologist in New York who earned $472,445 in 1994, and $404,593 in 1995, before his income "plummeted" to a "mere" $318,217 in 1996 (his original schedules indicated an income of $276,000, but this apparently was revised upward during the bankruptcy case). He also had an additional amount of $390,216 in various pension or profit-sharing plans. Finding this pittance of $318,000 impossible to live on, Dr. Kornfield filed bankruptcy. And well he might: How else could he be expected to meet his lease payments on his new Landrover Rangerover (one of three cars the family owned or leased), his annualized living expenses of $157,380 per year (including $1,200 per month for food), the $507,000 he owed on his mortgages on a foreclosure of his $2.5 million house, and his obligations of $53,640 per year to send his children to the most prestigious and expensive private high school in the area? *In re Kornfield*, 211 B.R. 468 (Bankr. W.D. N.Y. 1997). As Bankruptcy Judge John C. Ninfo, II, concluded in his Bankruptcy Court opinion, "The Kornfields appear unwilling to make any effort to reduce their . . . voluntary and excessive living expenses to enable them to pay something to their creditors." *Id.* at 482.

Page 83 PREV PAGE TOP OF DOC

How did we get from Harry Truman to Robert Kornfield in just a few generations? Available evidence suggests two overriding factors that explain the bankruptcy boom of recent years. First, is an increase in the economic benefits of filing bankruptcy and a contemporaneous drop in the economic costs associated with filing bankruptcy. Second, is a general decline in the personal shame and social stigma associated with filing bankruptcy.

The economic benefits of filing bankruptcy are potentially large, and they get larger as one's income and wealth rise. The most notable advantage of filing Chapter 7 bankruptcy is the ability to retain property in "exempt" property while walking away from obligations owed to creditors. Economist Michelle White of the University of Michigan has found that bankruptcy filing rates are, to some degree, positively related to the generosity of exemptions. Overall, White has found that at least 15% of households would benefit financially from filing bankruptcy, and that number rises if they plan strategically for bankruptcy, such as by converting nonexempt assets to exempts assets prior to filing. *See* Michelle J. White, "Why Don't More Households File for Bankruptcy?" 14 *Journal of Law, Economics, and Organization* 105 (1998); Michelle J. White, "Why it Pays to File for Bankruptcy: A Critical Look at the Incentives Under U.S. Personal Bankruptcy Law and a Proposal for Change," 65 *University of Chicago Law Review* 685 (1998). Thus, not only did filing rates rise after the doubling in the value of federal exemptions in 1994, but she further estimates that adopting the National Bankruptcy Review Commission's recommendation for a uniform federal level of exemptions would lead to an overall increase in bankruptcy filings of 89,000 per year. Moreover, because exemptions tend to protect certain types of property such as houses, cars, and the like, they are disproportionately favorable to upper-income earners who have the ability to funnel money into these particular types of exempt properties and maximize the value of the exemptions.

Page 84 PREV PAGE TOP OF DOC

There are also substantial other economic benefits associated with filing bankruptcy, such as the automatic stay, the stopping of the running of interest on unsecured debts, and, of course, the discharge of debts at the end of the process. Finally, there are substantial noneconomic benefits of filing bankruptcy, such as peace from one's creditors as they cease collection efforts.

At the same time that the benefits of filing bankruptcy have risen, the costs associated with filing bankruptcy have fallen. Most notably, the passage of the Bankruptcy Code in 1978 ushered in an era of more generous bankruptcy relief. Thus, several studies have shown a significant increase in the bankruptcy filing rate following the enactment of the 1978 Code.

Perhaps the greatest cost associated with filing bankruptcy is merely finding out about it as a viable option, or what economists call "search costs." The search costs of filing bankruptcy have fallen substantially in recent years. The rise of attorney advertising in the 1980s reduced the information costs to debtors of learning about bankruptcy as an option. The sheer number of bankruptcy filings and the publicity it has garnered has also raised public awareness of the bankruptcy system. An increasing number of bankruptcies are the result of the "water cooler" effect: people learning about bankruptcy from family members, friends, or co-workers, who report that it was cheap, easy, and put an end to creditors' collection efforts. Finally, the repeated vision of well-known entertainers, politicians, and others using the bankruptcy system has provided substantial "free advertising" for the system.

Not only have the search costs of learning about bankruptcy fallen, but the direct costs of filing have fallen as well. The large number of bankruptcy filings has engendered certain economies of scale that have reduced the out-of-pocket costs of filing bankruptcies. Thus, "do-it-yourself" bankruptcy books have become a staple of bookstores and even grocery store check-out lines. The creation of so-called bankruptcy "mills" has reduced the costs of obtaining an attorney for the typical high-volume, low-difficulty Chapter 7 case. Using teams of paralegals and secretaries, these attorneys represent thousands of debtors per year, mass-producing cheap Chapter 7 petitions at record speeds.

Page 85 PREV PAGE TOP OF DOC

This increase in the benefits of filing bankruptcy and decrease in the costs has been reinforced by a striking reduction in the personal shame and social stigma traditionally attached to the decision to file bankruptcy. Bankruptcy is a moral act, as well as a legal and economic act. It is a decision to repudiate one's promises, a decision not to reciprocate a benefit bestowed upon you by another. We teach our children from a very young age to keep one's promises because it is the right thing to do. Thus, it is not surprising that people traditionally have felt shame from breaking one's promises and that repudiating them in public through the bankruptcy system generally has been met with social disapproval. Harry Truman repaid his debts because he thought it was the right thing to do and to protect his good name. In today's world, it is hard to imagine either of these factors really constraining someone in Truman's position. To paraphrase Senator Moynihan, we have "defined bankruptcy deviancy downward" to the point where it has become a routine financial planning device rather than a option of last resort.

The conclusion that a decline in the shame and stigma associated with filing bankruptcy is responsible for the recent explosion in filing rates has been borne out in several recent studies. *See* F.H. Buckley & Margaret F. Brining, "The Bankruptcy Puzzle," 27 *Journal of Legal Studies* 187 (1998); Scott Fay et al., "The Bankruptcy Decision: Does Stigma Matter?" (working paper, University of Michigan Department of Economics 1998); David B. Gross & Nicholas S. Souleles, "Explaining the Increase in Bankruptcy and Delinquency: Stigma versus Risk-Composition" (working paper, Wharton School of Business, University of Pennsylvania 1998); Visa, U.S.A., Inc., "Consumer Bankruptcy: Causes and Implications" (1996). The findings of these studies is consistent with those of casual empiricism. For instance, credit unions report that nondelinquent borrowers are filing bankruptcy at an increasing rate, with no prior effort to work out any consensual repayment plan. The increasing number of these "surprise" bankruptcies suggests that bankruptcy more and more is looked at as an option of first, rather than last resort.

Page 86 PREV PAGE TOP OF DOC

The decline in the traditional shame and stigma associated with filing bankruptcy has had its largest impact on higher-income filers. As previously noted, the financial benefits of filing Chapter 7 are potentially greatest for higher-income filers, who generally have a greater ability to shield assets in bankruptcy and to manipulate the system for their benefit through savvy bankruptcy planning. As a result, the residual sense of shame and stigma attached to filing bankruptcy have had their greatest impact on restraining opportunistic filers by these individuals. As shame and stigma decline, therefore, the marginal impact will be felt most heavily with respect to upper-income debtors. This suggests that, absent reform, we will continue to see an ever-increasing number of high-income bankruptcy filers. Thus, not only is means-testing the right idea today, but it will become increasingly necessary in the future, as a means to counteract these underlying trends.

Beware Misleading Statistics

But in looking to past for lessons about bankruptcy reform, one must be careful. In particular, one must be wary of academic and other witch-doctors boiling-up a stew of misleading and irrelevant statistics designed to derail sensible and needed bankruptcy reform.

The most prominent of statistic that is trotted out to explain rising bankruptcy filing rates is a purported "correlation" between consumer debt and bankruptcy filing rates. Even if true, the simple and obvious to this is, of course, "so what? " Correlation does not equate to causation. I am aware of no studies that actually demonstrate a *causal* link between overall consumer debt levels and bankruptcy filing rates. Yet some scholars and commentators insist on drawing causal links from the crudest evidence of correlation. *See, e.g.*, Elizabeth Warren, "The Bankruptcy Crisis," 73 *Indiana Law Journal* 1079, 1081 (1998) ("The macrodata are unambiguous about the best *predictor* for consumer bankruptcy. Consumer bankruptcy filings rise and fall with the levels of consumer debt." (emphasis added)); *see also id.* at 1083 ("[Various studies] all demonstrate the correlation between rising levels of consumer debt and rising bankruptcy rates. The simple explanation of the rise in filings—bankruptcies rise as household debt rises—is undeniable.").

Page 87 PREV PAGE TOP OF DOC

This argument is implausible on its face. Overall debt levels simply cannot provide an explanation for the rapid run-up in bankruptcy filing rates in recent years. As one commentator has observed, even if debt-to-income ratios have worsened, they have done so gradually: "They did not get worse by 29% in 1996 over 1995, but bankruptcies did. They did not worsen again by 20% in 1997 over 1996, but bankruptcies did."

Moreover, the advocates of this thesis have failed to provide a persuasive explanation as to how debt could "cause" bankruptcy for individuals. More relevant, would be the *current* debt burden, the amount that debtors are obligated to pay each month on their various loans. The ability to meet one's obligations as they come due would certainly seem to be the more logical way of thinking about debt and individual bankruptcy than some sort of balance sheet test. Because of the low interest rates of recent years, *current* debt burdens have fallen even as *overall* debt levels have risen and remain below their all-time high. As a result of these low interest rates, borrowers should be able to carry the same or even greater debt levels with greater ease than before.

Pointing to "debt" as the source of consumer bankruptcy also ignores the fact that the amount of debt that consumers are willing to incur will be a function of the ease with which they can file bankruptcy and later discharge those debts. Hence, the debt level cannot be an exogenous variable that could "cause" bankruptcies because the overall debt level itself is, at least in part, caused by the bankruptcy law itself. If you reduce the "cost" of debt by making it easier to discharge, then you will get more of it. Nor does debt exist in a vacuum. It accumulates through conscious decisions to purchase goods and services. Thus, "too much debt" in many cases could be recharacterized as "too much spending," as was the case with Dr. Kornfield. It is not debt that causes bankruptcy for many people, it is a conscious choice to maintain an extravagant and unrealistic lifestyle rather than tightening one's belt and spending responsibly.

Page 88 PREV PAGE TOP OF DOC

It also will not do to blame credit card issuers. Because of their visibility, credit card issuers have become easy villains for those seeking to blame creditors. As Judge Jones and I wrote, "[C]redit card issuers have become the modern equivalent to William Jennings Bryan's 'Cross of Gold,' crucifying consumers in the pursuit of ever-greater profits." But blaming credit card issuers for the bankruptcy boom is implausible. First, the total credit card debt burden of $529 billion pales in comparison to overall housing debt of $4 *trillion*, and housing debt has been increasing much faster than revolving debt in recent years. Second, most Americans are "convenience" users of credit cards who pay off their balances each month and therefore accrue no interest fees or service charges. Focusing on those who revolve balances from month-to-month ignores the reality that few Americans fit this profile.

Those who would vilify credit card issuers also misunderstand the role that credit cards play in the modern American economy. Entire segments of our economy, such as internet and catalogue shopping, would not exist without consumer access to credit cards. They have aided in the growth of millions of new businesses by reducing their risk of loss from nonpayment of accounts and by enabling them to compete with Sears and other big retailers who used to dominate the retail credit market. Credit cards enable individuals to deal with short-term emergencies like car and home repairs, without having to hoard large amounts of cash in non-interest bearing checking accounts, not to mention all the fringe benefits of frequent flyer miles, rental car insurance, purchase price protection, and even cash back bonuses. Moreover, the credit card industry has revealed itself to be ferociously competitive. In a market with 6,000 issuers and millions of consumers it is hard to imagine it being otherwise. And, indeed, after an early period of high profitability following deregulation, profits on credit card issuers have decreased substantially in recent years. Critics continue to sound warnings about the "credit card menace" without realizing that the credit card Cold War is over and it is the consumers who have won.

Page 89 PREV PAGE TOP OF DOC

Despite this, criticisms of the credit card industry persist. Much of the criticism is grounded in factual errors. For instance, many critics rely on a study by economist Lawrence Ausubel that purports to persistent supranormal returns to credit card issuers, pointing to alleged "stickiness" in credit card interest rates as evidence. Scholars have pointed out numerous flaws in Ausubel's methodology and conclusions, many of which are discussed in Edith H. Jones and Todd J. Zywicki, "It's Time for Means-Testing," 1999 *BYU Law Review* (Forthcoming 1999). Among the errors that have been identified are a failure to account for the higher transaction costs and risk associated with credit cards, his huge overestimation of the number of consumers who revolve balances from month to month, arbitrariness in the financial institutions included in his data set, and the fact that his data runs out just at the point where heightened competition appeared on the scene. Given these problems, it is strange that many people nonetheless continue to place heavy reliance on Ausubel's research.

Access to credit cards is especially important for low-income borrowers, as they lack the options of more wealthy borrowers. For instance, low-income borrowers obviously will have less access to home equity loans than the rich. Absent credit cards, low-income borrowers faced with a short-term need for cash, such as the need for a new transmission for a car, will face an array of unfavorable options: selling personal assets, taking them to a pawn shop, or trying to get a short term loan from a bank that will probably charge them fees and an interest rate that substantially exceed that available on credit cards. Credit cards are a great convenience for many and there are few substitutes for the low transaction cost access to short-term credit offered by credit cards. *See* Dagobert L. Brito & Peter R. Hartley, "Consumer Rationality and Credit Cards," 103 *Journal of Political Economy* 400 (1995). Access to credit cards have democratized credit, making its advantages available to all when it previously was available only to the elite.

Page 90 PREV PAGE TOP OF DOC

Opponents of bankruptcy reform have trotted out a number of other misleading and irrelevant statistics designed to confuse the debate over the Act. For instance, critics of reform point to data that suggests that a certain percentage of bankruptcy debtors have been unemployed during the two years preceding bankruptcy, or have had health problems, or have gotten divorced, or suffered some other significant personal difficulty. This collection of data is somewhat interesting, and might be of some help if someone was considering scrapping the bankruptcy laws completely. But it is of questionable help in discussing bankruptcy reform generally, as it only studies those who have already filed bankruptcy and ignores those with similar problems who have not. See Michelle J. White, "Economic Versus Sociological Approaches to Legal Research: The Case of Bankruptcy," 25 *Law and Society Review* 685 (1991).

Even if this data were relevant in general, it is virtually useless in examining the provisions of the Act. The centerpiece of the Act is means-testing for high-income debtors who can repay a substantial portion of their debts with minimal economic or other hardship. The characteristics of the "average" or "typical" debtor is irrelevant; the Act targets the atypical, high-income filer. Virtually by definition, those who have been unemployed for long periods of time will also have low incomes and thus will be unaffected by this provision of the Act; those who still have high incomes will find solace under the hardship exception of the Act. Moreover, means-testing does not deny anybody the right to file for bankruptcy or to receive a bankruptcy discharge, it just requires that if you file, and if you are a high-income earner who can pay back a substantial portion of your debts without significant hardship, then you must pay what you can. So the sources of an individual's debts would seem to be largely irrelevant to the questions presented by the Act. Nothing in the means-testing provision of the Act will take away the right to file bankruptcy, and most of those who are most vulnerable simply will be unaffected by its central provisions.

Page 91 PREV PAGE TOP OF DOC

Factors such as unemployment, health problems, or divorce certainly account for some percentage of filers in the bankruptcy system, and certainly explain some of the regional variations in filing rates. But those problems simply cannot account for the nationwide 20% annual increases in bankruptcy filing rates we have seen in recent years. In an economy of low unemployment and high growth, unemployment cannot explain even a fraction of the 20% growth rates in bankruptcy filings during recent years. There has been no real increase in health care costs for several years, thus health care costs have remained constant even as bankruptcy filing rates have skyrocketed. Similarly, divorce rates have stabilized after years of rising. Given the facial implausibility of asserting these factors as explanations for surging bankruptcy filing rates, it should not be surprising that scientifically-controlled empirical studies have failed to find a correlation between these factors and bankruptcy filing rates.

Perhaps more interesting than what such scholars include on such lists is what is omitted. For instance, a 1997 Gallup Poll revealed that 10% of bankruptcy filers filed partly because of tax burdens, a percentage that exceeded college expenses and death in the family, and was five times higher than those reporting that gambling pushed them into bankruptcy. But this statistic reflects only the direct impact of taxes on bankruptcy and probably understates the true impact of high taxes on bankruptcy filing rates. Taxes devour massive amounts of personal income that would otherwise be available to finance consumption or savings without having to take on debt. Moreover, tax burdens have increased substantially during the same period that bankruptcies have risen, and now stand at 21.8% of GDP a record peacetime high. From 1990 to 1997 taxes increased 58%, by contrast, consumer spending increased only 43% during this period. This increased tax burden has been reflected in a savings rate in 1997 of 2.1%, the lowest level since the Great Depression. By eating away at individual incomes, taxes reduce personal savings rates, which may make households more vulnerable to income interruptions or large and unexpected increases in financial liabilities. While the effect of high taxes on bankruptcy has not been studied in detail, it is at least as plausible a factor as other factors that have been advanced, and it appears to be ideology rather than science that has led them to be artificially excluded from the debate.

Page 92 PREV PAGE TOP OF DOC

The Future of Bankruptcy and Bankruptcy Reform

A world where financial promises are cast away at the first opportunity is not a pretty one. Consider Memphis, Tennessee, the "bankruptcy capital of America." In 1996, 4.3% of Memphis families filed bankruptcy, almost 1 in 23. According to a *Fortune* magazine article, there is a "culture of bankruptcy" and bankruptcy is "a way of life." *See* Kim Clark, "Why So Many Americans are Gong Bankrupt," *Fortune* 24 (Aug. 4, 1997). The implications of a world of such widespread bankruptcy are alarming. As I wrote with Judge Edith H. Jones, "In this post-bankruptcy apocalyptic world, trust has all but disappeared in routine arms'-length transactions that go unnoticed elsewhere." *See* Edith H. Jones and Todd J. Zywicki, "It's Time for Means-Testing," 1999 *BYU Law Review* (Forthcoming 1999). Consider *Fortune*'s description of everyday financial life in Memphis: "It's almost impossible to cash checks in Memphis. Used-car dealers charge their wholesale cost as a down payment. And lenders are either tightening or giving up."

A belief in promise-keeping and personal financial responsibility are valuable social values that can erode rapidly. In Memphis, everyone is considered a cheat until proven otherwise. The result has been to paralyze the system of consumer credit in Memphis. In the end, all consumers pay for bankruptcy through higher prices and higher interest rates. Reform the bankruptcy laws before all of America goes the way of Memphis—or beyond.

Mr. **GEKAS.** We now turn to Professor Klee.

STATEMENT OF KENNETH KLEE, PROFESSOR, UNIVERSITY OF CALIFORNIA-LOS ANGELES SCHOOL OF LAW, LOS ANGELES, CA, ON BEHALF OF THE NATIONAL BANKRUPTCY CONFERENCE

Page 93 PREV PAGE TOP OF DOC

Mr. **KLEE.** Thank you, Mr. Chairman.

The National Bankruptcy Conference is pleased to testify today, and we do support balanced bankruptcy reform. We support reform that would remove abuses on the debtor side by imposing caps on exemptions, by preventing repeat filings, and by permitting courts to dismiss abusive cases based on a totality of the circumstances, which would include the debtor's ability to repay.

But we don't believe, Mr. Chairman, that a formula works; and, unfortunately, H.R. 833 contains a formula that doesn't work. H.R. 833 is opposed by the conference because it is inefficient, unbalanced, misdirected, and technically flawed. Let me elaborate on those points for the subcommittee.

It is inefficient because, in our view, the costs of the bill will exceed its benefits. The studies that we have read show 3 percent of the debtors "abuse" the system, yet 97 percent of the debtors who don't are going to have to fill out the forms and be subject to examination by the trustees in every single case. We think this will lead to more judges, more trustees, and more costs to the system.

We believe the bill is unbalanced because it favors broken families over intact families. By protecting alimony and child support, a noble and worthy objective, the bill is good, but the bill does not leave the intact family in chapter 13 with anything other than the IRS collection allowances which are not as liberal as family law allowances in many circumstances.

Page 94 PREV PAGE TOP OF DOC

The bill fails to adequately address creditor abuse. There is insufficient disclosure on the costs of credit, and there is no disallowance of creditor's claims when their loan is in violation of Truth in Lending Laws or the Fair Debt Practices Act. And, there is a prohibition in the bill against class actions against creditor abuse, such as the abuse that Sears perpetrated nationwide that resulted in a $60 million judgement. The elimination of the class action remedy is a very serious problem with the bill, and we oppose it.

Finally, the bill disrupts chapter 11. There are business provisions that are being overlooked in this bill because of the consumer issues. I understand that is not the focus of today's hearing but I have dealt with it in my testimony.

In particular, the provision that requires assumption or rejection of executory contracts and unpaid leases within 6 months—within 180 days, will kill retail reorganizations. If you have a chapter 11 case that files in January or February, unless the business operates through Christmas, you don't know what the sales are going to be; and to force assumption or rejection decisions prematurely will be disruptive.

We also believe the bill is misdirected because it does nothing to deal with the education of debtors, other than some efforts at counseling.

It is debt default levels that are driving bankruptcies, contrary to what Professor Zywicki says. In my experience, if people don't have debt, they don't go into bankruptcy; and the debt is what is driving bankruptcy.

We need to do something to deal with the fact that even if the bankruptcy laws were repealed, debtors would be in default and lenders would be suffering losses. This bill only encourages creditors to make more bad loans, because debts will be nondischargeable, and debtors would be forced into chapter 13.

Page 95 PREV PAGE TOP OF DOC

The $550 "tax" on every American family that has been talked about is a myth. We believe that little or nothing will be passed on to consumers in terms of savings. Rather, there will be profits for the banks and credit card companies who will benefit from the bill. We evidence this by recalling that the procreditor amendments that were enacted in 1984 did not result in a reduction in interest rates on charge cards.

Finally, the bill is flawed technically. And, Mr. Chairman, we have attached an appendix here that shows various technical problems. We are hopeful that those will be remedied.

We believe under section 102 that the bill will force debtors out of chapter 7, even when they are ineligible to file for chapter 13, and that should not happen.

We also believe that the bill applies the means test to debtors that are poor, with income less than the median national income.

And I have read section 102, and I want to take the chairman and the subcommittee through an example, because I believe the formula doesn't work.

If a debtor has a $50,000 mortgage and a $10,000 secured car loan and $7,200 in credit card bills and earns $18,000 a year, or $1,500 a month in gross income, and after spending, under the IRS collection standards, for food, clothing and shelter and having the taxes paid, the debtor has only $30 a month left over, this bill would prevent the debtor from filing under chapter 7. And this is the way it works: $30 a month times 60 months is $1,800. $1,800 is a quarter, or 25 percent, of the $7,200 in unsecured credit card debt that this debtor has.

Page 96 PREV PAGE TOP OF DOC

Because section 102 of your bill says that you are presumed to have an abuse. You can pay at least the lesser of 25 percent of your unsecured debt or $5,000, this debtor's ability to pay $1,800 will mean that the debtor is presumed to be ineligible for chapter 7. $30 a month, of course, doesn't justify imposing on the taxpayers a 5-year chapter 13 plan. But this debtor won't be able to confirm a chapter 13 plan, because the interest on any mortgage arrearage or car arrearage will continue to accrue in chapter 13. That is not calculated under the bill's formula, and the trustee's fees in the chapter 13 case will more than consume the $30 a month.

So we believe, Mr. Chairman, that if you want to go with this approach, and we oppose a formula approach, but if you want to do it, the formula needs to be tightened up and made to work so it does truly target the very high-income people that Mr. Wallace talked about.

Thank you.

Mr. **GEKAS.** We thank the professor.

[The prepared statement of Mr. Klee follows:]

PREPARED STATEMENT OF KENNETH KLEE, PROFESSOR, UNIVERSITY OF CALIFORNIA-LOS ANGELES SCHOOL OF LAW, LOS ANGELES, CA, ON BEHALF OF THE NATIONAL BANKRUPTCY CONFERENCE

I. CONSUMER BANKRUPTCY

Page 97 PREV PAGE TOP OF DOC

A. Rhetoric Versus Reality

The Bankruptcy Reform Act of 1999 is controversial. Serious questions have been raised about many portions of this bill not only by bankruptcy professionals but also by the Administration generally, the First Lady, victims rights groups, groups representing the interests of women and children, groups concerned with civil rights, labor unions, the press, and campaign finance watchdog groups, among others.

It may seem difficult to believe that H.R. 833 is controversial after hearing repeatedly that this bankruptcy bill is necessary because bankruptcy currently imposes a "hidden tax" on every American family.(see footnote 3) The sponsors of this bill have suggested that those who believe in personal responsibility need not think twice before supporting this bill.

As bankruptcy experts, we do not analyze bankruptcy reform in rhetorical terms. We analyze the details and how this bill would work in reality. *Our analysis yields one inescapable conclusion: Members of Congress should think twice about this bill.*

Before discussing the details of this bill, some pervasive myths must be debunked.

1. Effect of this bill on the bankruptcy system

More than just a "means test." H.R. 833 contains dozens of provisions that have a substantial effect on *all* consumer bankruptcy filers, not just those with higher incomes. Many of these provisions erode the basic components of bankruptcy, such as the automatic stay and the discharge. Other provisions make it harder to confirm and complete a chapter 13 repayment plan. Still others introduce a host of new requirements, with automatic dismissal of the case as the penalty for noncompliance. This bill is full of special interest provisions that may help some creditors, but in doing so will hurt many others and society as a whole.

Page 98 PREV PAGE TOP OF DOC

Low income bankruptcy filers affected. Section 102 of this bill makes the means test applicable to all individual debtors.(see footnote 4) Under this bill, even a debtor with income below the poverty level could be forced out of chapter 7. It simply is misleading for anyone to suggest that debtors with incomes below $51,000 need not be concerned about the means test or the effects of this bill.

Hindrance to chapter 13 repayment. If you believe that more bankrupt families should repay some of their debts through a chapter 13 plan instead of filing for chapter 7, the Bankruptcy Reform Act of 1999 is not for you. *Provisions in this bill make chapter 13 unfeasible for many debtors, even those who file voluntarily choose chapter 13 over chapter 7.* The bankruptcy judges and chapter 13 trustees in your district and home town are likely to agree.

2. Effect of this bill on America

Our concerns about H.R. 833 are not limited to the effects on the bankruptcy system itself. We care about American families and want them to prosper. If we believed H.R. 833 would benefit American consumers, our position would be somewhat different. However, although this bill may increase short term profits for the small fraction of the population that holds stock in credit card companies, *it will not save every American family $550 a year or even $50 a year*. This bill may not save American families even 50 cents a year. Most independent and government economists and academics who have considered this issue agree that this bill may increase credit card company profits but will not reduce consumer debtors' borrowing costs.

Page 99 PREV PAGE TOP OF DOC

Like others, we also want America's businesses and lending institutions to be strong and profitable. Of course, the consumer credit industry is adequately equipped to adjust itself to reduce its losses and increase profits without government intervention. Even if government intervention were desirable, this bill is not the answer because *H.R. 833 will not reduce the number of consumers who default on their debts*. To the contrary, many independent and government economists and academics believe that *this bill will lead to increased extensions of credit to uncreditworthy consumer borrowers resulting in increased consumer defaults.*

3. New information should make you think twice about this bill

Finally, although you may have voted for legislation identical to this bill last fall, along with the majority of your colleagues on this Committee and in the House of Representatives, *information obtained since your last vote should make you think twice* before voting for this bill again.

First, *there is a new study of debtor abuse* in the bankruptcy system sponsored by the nonpartisan, not-for-profit American Bankruptcy Institute and conducted by Professors Culhane and White from Creighton University. The study reveals that chapter 7 is about 97% effective in filtering out debtors who can pay their debts, making the current bankruptcy system more efficient than most other government systems. The study also concluded that the credit industry has given you overly optimistic estimates on the dollars that it will recoup from this bankruptcy reform and purportedly would pass onto consumers.

Page 100 PREV PAGE TOP OF DOC

Second, since you last voted on this bill, *a single retail creditor has admitted to committing bankruptcy fraud in hundreds of thousands of cases* and is subject to a $60 million fine, the largest fine ever imposed for bankruptcy fraud. Unfortunately, this is not an isolated incident. The fraudulent and illegal practices are pervasive.

Thus, since you last voted on this bill, there is less evidence of debtor abuse and more evidence of creditor abuse. Yet the bill remains deficient in addressing creditor abuse and over-reacts in addressing debtor abuse. It is time for a more balanced bill.

B. Issues on which the National Bankruptcy Conference Agrees with the Co-Sponsors of this Bill

Notwithstanding serious concerns about the Bankruptcy Reform Act of 1999, *the National Bankruptcy Conference agrees with this bill's co-sponsors on several key points:*

The Conference *agrees* with the co-sponsors that more can be done to prevent individuals from using chapter 7 if they clearly can pay their debts by using chapter 13.

The Conference *agrees* with the co-sponsors that a restriction on repeat filing should be imposed.

The Conference *agrees* with the co-sponsors that forbidden activities of bankruptcy petition preparers should be proscribed so that they do not mislead financially distressed individuals and families.(see footnote 5)

Page 101 PREV PAGE TOP OF DOC

The Conference *agrees* with the co-sponsors that the exemption of retirement funds should be revised to promote more uniform treatment.

The Conference *agrees* with the co-sponsors that an audit system should be implemented to verify the accuracy of papers filed in bankruptcy cases, as long as the costs are contained.

C. Issues on which the National Bankruptcy Conference Disagrees with the Co-Sponsors of this Bill

Although the National Bankruptcy Conference endorses the above-mentioned key concepts, the Conference strongly disagrees with the approach taken in this legislation to address numerous issues, including the following:

The Conference *opposes* the means testing formula in this bill, particularly the use of expense standards established by the Internal Revenue Service(see footnote 6) or other similar sets of arbitrary guidelines. The means testing formula fails to distinguish between debtors who can and cannot pay. Furthermore*, the means testing formula does not promote personal responsibility because it benefits debtors with more debts of any kind and excessive expenses.*

Along the same lines, the Conference *opposes* the lack of court discretion in the proposed means test. Do not be fooled by the fact that the means test has been inserted into section 707(b) of the Bankruptcy Code, which generally is perceived to give the court discretion. *The proposed amendment to section 707(b) strips courts of meaningful discretion in determining which debtors can and cannot pay their debts*. Moreover, the means test requires that the chapter 7 trustee conduct an extensive review of the debtor's ability to pay under the formula in every single consumer chapter 7 case 5 days before the section 341 meeting of creditors, even before the trustee has met the debtor.

Page 102 PREV PAGE TOP OF DOC

The Conference *opposes* the provisions in this bill that make credit card debts and cash advances nondischargeable or create presumptions of nondischargeability. The case has not been made to justify additional special interest provisions for credit card companies, which, like other creditors, should be required to prove the debtor's bad intent before their debts survive bankruptcy while others are discharged.(see footnote 7)

The Conference *opposes* provisions that in practice will make chapter 13 unfeasible. For example, section 137 of this bill requires that a chapter 13 debtor make full payments to all secured creditors and lessors while also making full plan payments to the chapter 13 trustee. In addition, section 124 of this bill in effect requires that a debtor pay more than the purchase price of an item in order to keep it, regardless of its worth, inflating monthly plan payments beyond feasibility. More debtors will be expected to have 5 year plans, when most debtors today cannot complete 3 year plans. Those few debtors who actually make it to the end of a 5 year plan will not be able to discharge old tax debts, old credit card debts, or the interest that has accrued in the meantime.

D. Necessary Amendments that have been Omitted from the Bankruptcy Reform Act of 1999

The National Bankruptcy Conference also is troubled by the amendments *omitted* or *excluded* from the Bankruptcy Reform Act of 1999 that are essential to balanced bankruptcy reform. For example:

Exemptions. Last year, both the House and Senate bills at one time included provisions capping the use of state homestead exemptions at $100,000, which had bipartisan support. That provision has been stripped from this bill and replaced with less effective provisions that fail to prevent the use of unlimited exemptions and may produce more problems than they solve, hurting middle class families while allowing high income filers who plan carefully to enjoy unimpeded access to chapter 7.(see footnote 8) *Balanced bankruptcy reform requires that high value exemptions be capped.* Even a $200,000 cap would be far preferable to no cap at all.

Page 103 PREV PAGE TOP OF DOC

Reaffirmation review. The time has come to reinstate court review of proposed reaffirmation of unsecured and nominally secured debts, as was recommended in the bankruptcy bill that passed the Senate last year by a vote of 97 to 1. Court review already is a compromise position. Those concerned about financial rehabilitation of families and equal treatment of creditors should demand that reaffirmation review be part of balanced bankruptcy reform. Reaffirmation review need not be expensive or time consuming if the parties submit complete information about the terms of the proposed reaffirmation.

Abuse is a two way street. Any legislation designed to deter bankruptcy abuse is deficient without addressing creditor abuse. As previously explained, in the last few months new information became available suggesting that debtor abuse is down and creditor abuse is up. This bill not only fails to penalize creditor abuse, but it provides unprecedented preferential treatment to consumer lenders through a series of provisions that amount to little more than special interest legislation. This unbalanced approach is simply unjustifiable.

Bankruptcy and consumer credit. Closing the doors to a flu clinic does not cure a flu epidemic. By the same token, *restricting the bankruptcy laws, by itself, will not make people less laden with debt that they cannot repay. Bankruptcy filings are a function of consumer debt, which has risen dramatically*. The increase in consumer debt is due, at least in part, to the expansion of the accessibility of credit for a growing sector of the population, including marginal and uncreditworthy borrowers. Although the National Bankruptcy Conference does not propose that the lenders stop lending, the Conference does suggest that lenders provide more accurate information about the cost of the credit they are offering to consumers, particularly for open ended credit plans such as credit cards and home equity lines of credit. Credit is a product sold through savvy marketing, and the product should be labeled so that consumers know the contents and the risks, particularly when the contents and the risks change. *See, e.g.*, Robert D. Hershey, Jr., *Sales of Credit Card Accounts Are Hurting Many Consumers*, The New York Times, page 1 (March 2, 1999). The disclosure provisions in the bankruptcy bill that passed the Senate 97 to 1 last year should be added to the Bankruptcy Reform Act of 1999.

Page 104 PREV PAGE TOP OF DOC

In conclusion, although some concepts underlying the consumer bankruptcy provisions are commendable, the consumer bankruptcy provisions, as a whole, are not in the public interest. The Bankruptcy Reform Act of 1999 will not prevent wrongdoers from obtaining improper relief and will not promote personal responsibility. This bill may discourage financially troubled families from seeking relief at all, whether or not they can pay their debts. Without a doubt, this bill will increase the costs and complexity of the bankruptcy system.

Although the National Bankruptcy Conference is skeptical that the case has been made for radically overhauling the bankruptcy laws, the Conference remains willing, as it has been in the past, to help draft provisions or revise the provisions in this bill to implement Congress' intended policy decisions regarding consumer bankruptcy.

II. BUSINESS BANKRUPTCY

The consumer provisions of the Bankruptcy Reform Act of 1999 are likely to attract the lion's share of attention. However, the provisions of this bill affecting business bankruptcy cases cannot be ignored. The business bankruptcy provisions change the law and the leverage among parties and will have profound effects on whether and how struggling businesses reorganize. Business bankruptcy amendments must be adopted prudently because the effects of business bankruptcy reform do not stop at the door of the bankruptcy courthouse and pervade out of court workouts and commercial lending transactions.

A. Small Businesses

Page 105 PREV PAGE TOP OF DOC

Like legislation in the 105th Congress, this bill contains provisions drafted with the intent to eject nonviable businesses from chapter 11 and to minimize creditors' costs, particularly in chapter 11 cases lacking active creditor participation. Although the National Bankruptcy Conference does not quarrel with this objective, the Conference urges you to reject the small business proposal in this bill in its current form altogether or to replace it with a carefully crafted substitute.

In an effort to create an early detection system to identify and dispense with small businesses not worth saving, the small business provisions may foreclose the possibility of reorganization of small businesses that deserve to be reorganized. The contemplated changes could deny tens of thousands of businesses meaningful opportunities to restructure their obligations and to continue operations through effective reorganization under chapter 11 to the detriment of suppliers, employees, communities, and the economy at large. *This hostility to small business is unjust.*

It is important to remember that the proposed definition of "small business" captures the vast majority of chapter 11 cases. Indeed, *the definition of "small business" captures ALL business bankruptcy cases in many districts*, perhaps in your home town.

Thus, one should not be fooled by the labeling. These small business provisions would not be the exceptions to the general laws and rules of chapter 11 reorganization. They would become the laws and rules of chapter 11 reorganization. Moreover, one of the most significant "small business" provisions overhauling 11 U.S.C. §1112 (governing dismissal and conversion of chapter 11 cases), would apply to every single chapter 11 case. These provisions must be carefully considered, as the rehabilitation of America's businesses is at stake.

Page 106 PREV PAGE TOP OF DOC

In addition, as the National Bankruptcy Conference brought to your attention last year, some of the small business provisions have technical flaws so significant that they undermine the intent of the overall proposal and the chapter 11 process generally. The retention of these technical flaws is puzzling. Section 402, which redefines small business, was intended to encompass small businesses with debts under $4 million and without active creditors' committees. As drafted, it encompasses only small business bankruptcy cases in which active creditors' committees have been formed. Had this provision become law, it would have applied only to a small handful of cases while excluding all of the cases the proposal was designed to expedite. Likewise, section 412 was intended to impose restrictions on small business debtors that file for bankruptcy two or three times. Instead, as drafted, this provision denies automatic stay application in all chapter 11 cases, first filing or otherwise, except in certain involuntary cases. The automatic stay is one of the most crucial elements in a bankruptcy case. This is not a minor glitch and falls well below the standard of care of responsible lawmakers.

Undoubtedly, proponents of the small business proposal will provide you with anecdotes and horror stories about cases that languished in bankruptcy. Among the parade of horrors featured in these tales may be lapsed insurance, an endangered workforce, unpaid taxes, or disgruntled suppliers. These anecdotes are most unfortunate, but they are not attributable to current bankruptcy laws;(see footnote 9) nor is it clear that the small business proposal is the remedy for such irresponsible behavior.

The National Bankruptcy Conference agrees, however, that it is possible to improve the bankruptcy laws to ensure that small business bankruptcy cases proceed efficiently to the appropriate conclusion, whether that conclusion is reorganization through a confirmed plan, liquidation, or dismissal of the case. For this reason, the Conference has worked with the Commercial Law League of America to produce a modified version of the small business provisions in this bill, which is attached as Appendix E. The modified proposal adopts many of the aspects of the small business provisions in this bill, but increases their feasibility. We hope that the co-sponsors will work with us to improve these important provisions so that the American bankruptcy system, considered the most progressive in the world, continues to assist in the reorganization of America's small businesses.

Page 107 PREV PAGE TOP OF DOC

B. Large Businesses

Some of the nation's largest businesses have reorganized using the bankruptcy system, and the success rate for chapter 11 has increased since the early days of the Bankruptcy Reform Act of 1978. *A growing number of businesses in various industries and across the country are likely to restructure obligations or file for chapter 11 over the next few years*. Although it may be sensible to make modest improvements to business bankruptcy law, *now is not the time to make radical shifts that substantially alter the dynamic of plan negotiations or seriously undermine the opportunity for reorganization.*

1. Provisions supported by the National Bankruptcy Conference

The National Bankruptcy Conference supports some of the general business bankruptcy provisions contained in this bill. Among the provisions endorsed by the Conference are the following:

The Conference *supports* (subject to minor technical revisions) section 202, "Meetings of creditors and equity security holders," which authorizes the court to waive the requirement of a section 341 meeting of creditors after notice and a hearing if the debtor has filed a prepackaged plan of reorganization.

The Conference *supports* section 206, "Creditors and equity security holders committees," which clarifies that courts may review appointments to committees of creditors and equity security holders to ensure adequate representation of creditors or equity security holders.

Page 108 PREV PAGE TOP OF DOC

The Conference *supports* (subject to minor technical revisions) section 210, "Postpetition disclosure and solicitation," which permits postpetition solicitation of votes prior to court approval of a disclosure statement in a prepackaged plan of reorganization, but only for holders of claims solicited prior to commencement of the case in accordance with applicable nonbankruptcy law.

The Conference *supports* section 415, "Payment of interest," which provides explicitly that a single asset real estate debtor may make payments required by 11 U.S.C. §362(d)(3) from rents generated by the property. This section also changes the applicable interest rate to the nondefault contract rate and amends the deadline so that payments must be commenced or a plan filed on the later of 90 days after the petition date or 30 days after the court determines that the debtor is subject to these provisions when it is not immediately determined that the debtor is a single asset real estate debtor.

The Conference *supports* (subject to minor technical revisions) section 501, "Petition and proceedings related to petition," which clarifies that a chapter 9 (municipal bankruptcy) petition constitutes an order for relief.

The Conference *supports* section 502, "Applicability of other sections to chapter 9," which extends to chapter 9 the application of certain provisions of chapter 5 of the Bankruptcy Code that relate to the liquidation of securities contracts and the termination of swap agreements.

The Conference *supports* section 608, "Elimination of certain fees payable in chapter 11 bankruptcy cases," which eliminates postconfirmation quarterly United States trustee fees when the quarterly disbursement is less than $300,000.

Page 109 PREV PAGE TOP OF DOC

The Conference *supports* section 813, "Tardily filed priority tax claims," which provides that late filed tax claims are entitled to distribution only to the extent that they are filed on or before the earlier of 10 days following the mailing to creditors of the trustee's report summary or the date on which the trustee commences distribution.

The Conference *supports* section 815, "Discharge of the estate's liability for unpaid taxes," which adds the bankruptcy estate to the list of parties protected from a tax claim once a governmental unit fails to respond to a request for a determination of taxes under 11 U.S.C. §505(b).

The Conference *supports* section 901, "Amendment to add chapter 15 to title 11, United States Code," which creates a chapter 15 of the Bankruptcy Code to deal with ancillary and other cross-border cases.

The Conference *supports* section 902, "Amendments to other chapters in title 11, United States Code," which makes conforming amendments to reflect the addition of chapter 15.

The Conference *supports* (subject to minor technical revisions) section 1117, "Preferences," which amends 11 U.S.C. §547(b) so that in the event of an avoided security interest given by a debtor between 90 days and 1 year before bankruptcy to a noninsider for the benefit of an insider, the security interest shall be considered to be avoided as a preference only with respect to the insider.

In addition, the legislation contains provisions that the Conference would support if certain modest substantive changes were made. For example, the Conference *would support* section 216, "Defaults based on nonmonetary obligations," if language referring to intellectual property were deleted.(see footnote 10) Section 365 of the Bankruptcy Code should clarify the circumstances in which leases and executory contracts may be assumed in the event that there are incurable prepetition nonmonetary defaults of contractual clauses that are not considered penalty provisions. H.R. 833 should return to the language for this provision adopted in H.R. 764, the technical corrections bill that passed the House in the first session of the 105th Congress. While amending this provision, the Conference recommends that you revise 11 U.S.C. §365(c)(1) to clarify its intended operation in response to the Ninth Circuit Court of Appeals unfortunate decision *In re Catapult Entertainment, Inc.*, 165 F.3d 747 (9th Cir 1999), which held that a *debtor in possession may not assume the debtor's own executory contract* if applicable law would bar assignment to a hypothetical third party. Clearly, it is illogical to preclude a debtor in possession from assuming the debtor's own contract simply because the debtor in possession may not transfer it a nonexistent third party. On request, the Conference will provide statutory language to address this concern.

Page 110 PREV PAGE TOP OF DOC

2. Provisions opposed by the National Bankruptcy Conference

The objectionable business bankruptcy provisions in H.R. 833 are of such significance that they outweigh the benefits of the business provisions endorsed by the Conference. Some examples:

The Conference *opposes* section 204, "Protection of refinance of security interest," which amends 11 U.S.C. §547(e)(2) so that a transfer is deemed to be made at the time such transfer takes effect between the transferor and the transferee if the transferee perfects its security interest within 30 days, rather than 10 days. The Conference is concerned that this provision will harm the interests of and unfairly trap creditors who extend credit in reliance of the lack of a perfected security interest in specified collateral.

The Conference opposes section 205, "Executory contracts and unexpired leases," which replaces a flexible 60-day period with a rigid 180-day period to assume or reject a nonresidential real property lease, by providing that the court may extend the deadline past 180 days only on the motion of the nondebtor-lessor, unlike current law that permits the court to extend the deadline for cause on the motion of any party. This provision will be particularly troublesome for seasonal businesses, will preclude the reorganization of some businesses, and will force some debtors in possession to make premature decisions regarding their leases, to the potential detriment of other creditors. If a debtor in possession is required to assume the lease within 180 days and later cannot confirm a plan and must liquidate, the lessor will entitled to be paid 100 cents on the dollar while other creditors receive much less. *The Conference believes that the outer limit for assumption or rejection of a nonresidential real property lease should be the earlier of the effective date of the plan, dismissal, or conversion of the case.*

Page 111 PREV PAGE TOP OF DOC

The Conference *opposes* section 207, "Amendment to section 546 of title 11, United States Code," which prohibits a trustee from avoiding a warehouseman's lien for storage, transportation or other costs incidental to the storage and handling of goods, notwithstanding the trustee's otherwise applicable power to avoid those liens under 11 U.S.C. §545. It is inappropriate and harmful to other creditor interests to protect a statutory lien with disguised priority that otherwise would be ineffective against a bona fide purchaser.

The Conference *opposes* section 208, "Limitation," which extends the period for reclamation of goods under 11 U.S.C. §546(c)(1)(B) from 20 to 45 days. This amendment is an unwarranted expansion of reclamation rights that is prejudicial to the interests of other creditors. Trade creditors should be required to lobby state legislatures, not Congress, for expansion of reclamation rights because reclamation rights are a matter of state law, not federal law.

The Conference opposes section 213, "Period for filing plan under chapter 11," which limits the ability of a debtor in possession to obtain extensions of its exclusive right to file a chapter 11 plan to 18 or 20 months, respectively. This provision is misguided and may lead to more nonconsensual plans, which require costly litigation and often are not in the best interest of creditors. Some of the largest chapter 11 cases have taken several years for reorganization, particularly if the case involves mass tort or contract liabilities or complex operational problems, but ultimately work to the benefit of all parties. To amend the law in this fashion, when workouts and reorganizations are on the rise, would be a grave mistake.

The Conference *opposes* section 1012, "Asset-backed securitizations," which explicitly excludes from "property of the estate" cash, receivables, securities, and other financial assets transferred by the debtor in connection with an asset securitization under which investment grade rated securities have been issued. Under this provision, the debtor is considered to have transferred assets prepetition if the assets were transferred pursuant to a written agreement that states that the assets were conveyed with the intention of removing them from the estate of the debtor, regardless of whether the debtor holds an interest in the issuer or securities held by the issuer, whether the debtor has continuing obligations to repurchase, service, or supervise the servicing of eligible assets, or the characterization of the transfer for other purposes. This provision is bad policy. It will hurt creditors and decrease the likelihood that a business can reorganize because the business will have no cash collateral to fund operations. Rating agencies and private parties should not be authorized to make the legal determination of whether an asset is property of a bankruptcy estate. *This provision also impedes on states' rights. Transactions that are not sales under state law should not be treated as sales by federal bankruptcy law to the detriment of the estate and unsecured creditors.*

Page 112 PREV PAGE TOP OF DOC

The National Bankruptcy Conference stands ready to assist Congress in improving its set of business bankruptcy amendments.

III. FARM BANKRUPTCY

A. Family Farmer Reorganization Should Not be Held Hostage to Omnibus Legislation.

Although the Bankruptcy Reform Act of 1999 contains a provision making chapter 12 permanent, it is unlikely to be enacted before chapter 12 is set to expire on April 1, 1999. H.R. 808 passed by the House Judiciary Committee on March 2, 1999, extends chapter 12 for only another 6 months through October 1, 1999, notwithstanding efforts by Rep. Baldwin and others to provide additional stability for family farmer reorganization.

Chapter 12 expired last fall for nearly a month while Congress debated the same controversial bill that again is being considered. Chapter 12 was saved only by a last minute addition to the Omnibus Appropriations bill. In the meantime, *farmers were precluded from seeking relief under chapter 12* and the status of pending cases was called into question.

Some lenders may have concerns about the details of chapter 12, which is arguably less protective of creditors' rights than chapter 11. However, chapter 11 and other chapters of the Bankruptcy Code have proven to be too limiting in the circumstances unique to farming operations.

The National Bankruptcy Conference, along with the American College of Bankruptcy and the Commercial Law League of America, have submitted a statement supporting Senator Grassley's bill, S. 260, its House counterparts, H.R. 763 and H.R. 706, all of which make chapter 12 permanent.(see footnote 11) There is no justification for making the continued existence of chapter 12 dependent on the remainder of this controversial omnibus bill.

Page 113 PREV PAGE TOP OF DOC

B. Bankruptcy Law Should Provide Parallel Treatment for Family Farmers and Other Small Businesses.

Although the National Bankruptcy Conference supports the continued existence of a separate chapter for family farmer reorganization, it also recognizes that family farms are in fact small businesses and thus should be subject to some of the same requirements that currently are recommended for small businesses. At the very least, family farmers should be subject to similar disclosure requirements, mandatory status conference attendance, dismissal and conversion provisions, and repeat filing restrictions. Proposed amendments to this effect are attached to this statement as Appendix E.

III. OTHER ISSUES WARRANT INCLUSION IN THE BANKRUPTCY REFORM ACT OF 1999

A. Partnership Bankruptcies

Since the Bankruptcy Reform Act of 1999 intends to be comprehensive and will affect all kinds of bankruptcy cases, the co-sponsors should not miss the opportunity to include a package of uncontroversial amendments that would dramatically improve the functioning of partnership bankruptcy cases. Currently, the Bankruptcy Code provides insufficient guidance for partnership cases, and the guidance that it does provide applies primarily in chapter 7 cases. The draft statutory language that is attached to this statement as Appendix A is based substantially on years of work by the American Bar Association, the National Bankruptcy Conference, and the National Bankruptcy Review Commission. A text explanation of the draft statutory language is attached to this statement as Appendix B.

Page 114 PREV PAGE TOP OF DOC

B. Mass Future Claims

For similar reasons as stated above, the Bankruptcy Reform Act of 1999 should include provisions dealing with all types of mass claims, building on and simplifying the asbestos amendments added to the Bankruptcy Code by the Bankruptcy Reform Act of 1994. The National Bankruptcy Conference has spent years drafting, revising, and refining such a proposal, and much of that proposal was discussed extensively and supported *without dissent* by the National Bankruptcy Review Commission. The proposal makes clear that claims based on past actions of a business may be addressed through the bankruptcy process whether or not injuries have been manifested, requires adequate representation for unidentified claim holders, conditions discharge of claims on the sufficient funding of a trust or other payment mechanism, and channels claims to that pool of resources to be distributed when the claims become cognizable. Among other uses, the mass future claims proposal could provide a sound mechanism to guide the reorganization of tobacco companies, enabling them to satisfy their obligations to innumerable injured parties. Even if Congress bans the sale of tobacco in the United States, worldwide sales still might be sufficient to fund these types of plans. Draft statutory language and an explanation of the provisions are attached to this statement as Appendices C and D.

C. Health Care Bankruptcies

Perhaps even more than other businesses, health care providers increasingly are facing overwhelming financial problems. For this reason, the National Bankruptcy Conference believes that Congress should provide additional guidance in the Bankruptcy Code for health care businesses in bankruptcy, particularly to ensure that patients receive sufficient protection. The Conference was pleased to assist Senator Grassley last year in considering HMO bankruptcy eligibility and would be glad to assist the House Judiciary Committee on any element of health care bankruptcy reform. The Conference supports some of the health care provisions in S. 1914 from the 105th Congress, the Business Bankruptcy Reform Act of 1998, but believes that others require further analysis and revision.

Page 115 PREV PAGE TOP OF DOC

IV. MINIMIZE PIECEMEAL CHANGES TO BANKRUPTCY LAW THROUGH OTHER COMMITTEES

While the Judiciary Committee considers the comprehensive Bankruptcy Reform Act of 1999, other bills are moving through Congress containing provisions altering the rights and obligations of parties in bankruptcy. This piecemeal approach to bankruptcy reform is dangerous. Because bankruptcy is a collective proceeding, many interests are affected when the law is changed to favor one party. Other committees that do not regularly consider bankruptcy are less likely to appreciate the effects of special interest provisions on a collective bankruptcy case. For this reason, *it is imperative that all legislation changing the rights of one or more parties in bankruptcy is considered by the Judiciary Committee*. In addition, any changes affecting bankruptcy law should be made to title 11 and not hidden elsewhere in the vast United States Code.

The majority of these hidden provisions are designed primarily to give special treatment to governmental or quasi-governmental agencies. Those who favor a smaller, more limited government with less bureaucracy should not let these provisions become law without review by legislators with bankruptcy law expertise.

Although advocates of these provisions often argue that these provisions are necessary to protect the government fisc, many of these special interest provisions are inconsistent with the provisions of Bankruptcy Reform Act of 1999 that seek to minimize losses to private creditors. The special interest government amendments tend to be short sighted fixes that will create additional problems in the future, not just in the bankruptcy system but in the larger context of financing and borrower-lender relations. To the extent that these provisions respond to legitimate concerns regarding current loopholes in the bankruptcy system, the National Bankruptcy Conference stands ready to assist Congress in crafting alternative solutions that may be less harmful to the interests of other parties.

Page 116 PREV PAGE TOP OF DOC

Some examples of these provisions:

FCC. The Federal Communications Commission repeatedly has sought special treatment in bankruptcy cases, such as seeking to amend the Communications Act rather than the Bankruptcy Code to make bankruptcy laws inapplicable to actions of the FCC with respect to certain licenses, notwithstanding the automatic stay in bankruptcy. The FCC's wish list also requests that the FCC be "deemed" to have a perfected, first priority security interest in certain licenses or construction permits and any proceeds, which may hinder the licensee's ability to obtain the same level of private financing to make the purchase of the license. Not only does the FCC want these significant amendments, but the FCC wants these significant amendments to apply *retroactively*, which surely would be challenged on Constitutional grounds by parties who extended credit or borrowed under a different set of legal rules and assumptions. The amendments almost became law in the Omnibus Appropriations bill for 1999 and likely will resurface in the budget process again this year.

HHS. Like many bills last year, section 9 of the Home Health Integrity Preservation Act of 1999 (S. 255) contains provisions related to the rights of the Department of Health and Human Services and the bankruptcy treatment of debts owed to by the debtor to HHS and vice versa. Notwithstanding the significant effects of this bill on bankruptcy law and health provider bankruptcy cases (which by many accounts are becoming more frequent), this bill does not amend title 11 and apparently is not being considered by the Judiciary Committee. Although it is important to protect the integrity of the Medicare system, the bankruptcy related amendments in section 9 go much farther than necessary and will harm the interests of creditors and further impede potential rehabilitation of health providers. Instead of taking this piecemeal approach, health provider bankruptcy cases should be analyzed and addressed comprehensively with the assistance of experts in health law and bankruptcy law. The National Bankruptcy Conference and the Commercial Law League of America previously have submitted a joint position statement on this bill.

Page 117 PREV PAGE TOP OF DOC

DOT. Section 4 the Airline Competition and Lower Fares Act (H.R. 272), states that a slot (operational authority to land or take off at an airport) shall not be considered an asset for any purpose, including for collateral, for any agreement that would require forfeiture of the slot, or in any bankruptcy proceeding. Although some observers may believe that this provision serves the public interest by permitting the Secretary of Transportation to reallocate slots held by financially troubled airlines, this significant legal change may hinder competition and have other adverse effects. The right to take off and land at an airport provides a significant basis for obtaining necessary financing and is critical in airline reorganization cases. If the bankruptcy estate of an airline is divested of any legal interest in a slot and the automatic stay is inapplicable to actions pertaining to the slot, reorganization of otherwise viable airlines may be impossible, harming the interests of trade suppliers, lenders, employees, and ultimately the American public. In addition, this change increases the risk associated with airline financing and may decrease its availability, hampering the goal of increased competition in the airline industry. Although section 4 may be well-intentioned, it unfortunately is another example of the Federal government giving itself preferential treatment over private parties in a collective proceeding. This preferential treatment ill-serves our market economy. The Judiciary Committee should take a careful look at this provision.

Miscellaneous nondischargeability provisions for government obligations. In the first few weeks of the 106th Congress, quite a few bills were introduced in the Senate that would make additional debts nondischargeable. For example, section 201 of the "Soldiers', Sailors', Airmen's and Marines' Bill of Rights Act of 1999" (S. 4) provides that a discharge in bankruptcy entered 5 years after termination of an underlying agreement to complete a certain period of active duty does not discharge an obligation to repay the bonus. In addition, section 7 of the "Options for Excellence in Education Act of 1999" (S. 50) excepts from bankruptcy discharge the reimbursement obligation of a teacher for a State stipend who fails to obtain certification or licensure or employment. Section 2 of the "Troops to Teachers Program Improvement Act of 1999" (S. 389) provides that the obligation to repay certain teacher bonuses may not be discharged in bankruptcy. Whether or not these provisions are good policy in the few bankruptcy cases that will involve these reimbursement obligations, these provisions will have a significant effect and yet will not be found anywhere in the Bankruptcy Code unless the Judiciary Committee ensures that amendments are made to title 11.

Page 118 PREV PAGE TOP OF DOC

CONCLUSION

The National Bankruptcy Conference thanks the members of the Subcommittee on Commercial and Administrative Law for considering its views on bankruptcy reform. The Conference makes itself available to the Subcommittee for assistance with this difficult subject. Bankruptcy reform is not a simple undertaking. *Balance and quality must be restored or reform should be rejected.*

APPENDIX A: PROPOSED PARTNERSHIP AMENDMENTS

Sec. 601. Short Title.

This title may be cited as the "Bankruptcy Partnership Amendments".

Sec. 602. Definitions.

Section 101 of title 11 of the United States Code is amended by—

(1) inserting in alphabetical order among the definitions in section 101 the following additional definitions:

"(—) 'former general partner' means, in a case concerning a partnership, entity that is liable under applicable nonbankruptcy law for one or more debts of the partnership by being, before but not as of the date of the filing of the petition, a general partner, whether actual, purported, implied, or by estoppel, or a limited partner exercising control, in the debtor or in a former, predecessor or affiliated partnership;";

Page 119 PREV PAGE TOP OF DOC

"(—) 'general partner' means, in a case concerning a partnership, entity that is liable under applicable nonbankruptcy law for one or more debts of the partnership by being, as of the date of the filing of the petition, either a general partner, whether actual, purported, implied, or by estoppel, or a limited partner exercising control, in the debtor or in a former, predecessor or affiliated partnership;"; and

"(—) 'partner' means general partner, former general partner or limited partner;";

(2) amending section 101(18)(B)(ii) of title 11 of the United States Code to read:

"(ii) its aggregate debts do not exceed $1,500,000 and not less than 80 percent of its aggregate noncontingent, liquidated debts (excluding a debt for one dwelling which is owned by such corporation or partnership and which a shareholder, general partner, or limited partner maintains as a principal residence, unless such debt arises out of a farming operation), on the date the case is filed, arise out of the farming operation owned or operated by such corporation or such partnership;";

(3) amending section 101(32)(B) of title 11 of the United States Code to read:

"(B) with reference to a partnership, financial condition such that the sum of the partnership's debts is greater than the aggregate of, at a fair valuation—

Page 120 PREV PAGE TOP OF DOC

"(i) all of the partnership's property, exclusive of property of the kind specified in subparagraph (A)(i) of this paragraph;

"(ii) the sum of the excess of the value of each general partner's nonpartnership property, exclusive of property of the kind specified in subparagraph (A) of this paragraph, over such partner's nonpartnership debts, but only to the extent that the partner is personally liable under applicable nonbankruptcy law for the debts of the partnership; and

"(iii) the sum of the excess of the value of each former general partner's nonpartnership property, exclusive of property of the kind specified in subparagraph (A) of this paragraph, over the partner's nonpartnership debts, but only to the extent that the partner is liable under applicable nonbankruptcy law for the debts of the partnership;";

(4) amending section 101(41) of title 11 of the United States Code to read:

"(41) 'person' includes individual, partnership (including a partnership in dissolution), and corporation, but does not include governmental unit;"; and

(5) renumbering each of the definitions in section 101 in numerical order, starting from "(1)".

Sec. 603. Treatment of Partnerships in Bankruptcy.

Page 121 PREV PAGE TOP OF DOC

(a) Chapter 7 of title 11 of the United States Code is amended by striking section 723 and the item relating to section 723 in the table of sections.

(b) Chapter 5 of title 11 of the United States Code is amended by adding at the end:

"SUBCHAPTER IV—PARTNERSHIPS

"§561. Unenforceability of certain provisions

"Notwithstanding any provision in an agreement or in applicable nonbankruptcy law, a partnership may not be terminated, dissolved, or modified, and any right or obligation among the partners in their capacity as partners or of a partner in connection with the partnership may not be terminated or modified, at any time after the commencement of the case solely because of a provision in the agreement or applicable nonbankruptcy law that is conditioned on—

"(1) the insolvency or financial condition of the debtor at any time before the closing of the case;

"(2) the commencement of a case under this title; or

"(3) the appointment of or taking possession by a trustee in a case under this title or a custodian before the commencement of the case.

Page 122 PREV PAGE TOP OF DOC

"§562. Disclosures by partners

"(a) Unless the court orders otherwise, on request of the trustee, each person that is, or within one year before the commencement of the case was, a general partner or former general partner in the debtor, that is not a debtor in a case under this title shall provide to the trustee, or such other person as may be designated by the court, information regarding the partner's assets, liabilities and financial condition and financial affairs as may be required by the court or by applicable rule. On request of a party in interest or the United States trustee and after notice and a hearing, the court may order any other former general partner to provide such information to the trustee or to such other person as the court orders.

"(b) Except as otherwise ordered by the court for cause, including to protect any bona fide confidentiality concerns of the general partner or former general partner, the trustee or other person designated by the court to receive the information provided under subsection (a) of this section shall maintain and provide to parties in interest and to the United States trustee, on reasonable request, the information provided under subsection (a) of this section and such other information regarding the general partners and former general partners in the partnership as may be required by the court or by applicable rule.

§563. Stay of acts or proceedings against partners

"(a) After notice and a hearing and for cause, the court may stay—

"(1) an act, action, or proceeding to collect, assess, secure, or recover from a general partner or former general partner in the debtor on account of a claim against the debtor that arose before the commencement of the case; or

Page 123 PREV PAGE TOP OF DOC

"(2) an act, action, or proceeding by a general partner or former partner in the debtor to collect, assess, secure, or recover from a general partner or former general partner in the debtor a claim arising out of or relating to the debts of the debtor that arose before the commencement of the case.

"(b) The court may not issue a stay under subsection (a) of this section unless—

"(1) the partner protected by the stay consents to the jurisdiction of the court for the purposes of enforcing the provisions of this subchapter;

"(2) the partner has complied with or undertakes promptly to comply with section 562 of this title; and

"(3) the court orders the partner not to incur obligations or transfer property except as provided in the order or in an order issued under section 564(e) of this title.

"(c) On request of a party in interest, and after notice and a hearing, the court, for cause, may grant relief from a stay issued under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning the stay.

"(d) If applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period for commencing or continuing an action other than in a bankruptcy court on a claim against the partner, the commencement or continuation of the action is stayed under subsection (a) of this section, and the period has not expired before the issuance of the stay, then the period does not expire until the later of—

Page 124 PREV PAGE TOP OF DOC

"(1) the end of the period, including any suspension of the period occurring on or after the issuance of the stay; or

"(2) 30 days after notice of the termination of the stay with respect to the claim.

"§564. Rights of partnership trustee against partners

"(a) If there is a deficiency of property of the estate to pay in full all claims that are allowed in the case and with respect to which a partner in the debtor is liable, the trustee shall have a claim against each partner that is not a debtor in a case under this title to the extent that, under applicable nonbankruptcy law, the partner is personally liable for the deficiency, without adjustment on account of any right of contribution or reimbursement of or against such partner.

"(b) Notwithstanding section 728(c) of this title, the trustee has a claim against the estate of each partner that is a debtor in a case under this title for the full amount of all claims of creditors allowed in the case concerning the partnership to the extent that, under applicable nonbankruptcy law, the partner is personally liable for the claims.

"(c) The amount of a claim of the trustee against a general partner or former general partner under this section shall be estimated for all purposes if the determination of the amount would unduly delay administration of the case concerning the partnership or unduly prejudice the ability of the trustee to recover on the claim.

Page 125 PREV PAGE TOP OF DOC

"(d) Pending recovery of a claim under this section, the court, after notice and a hearing, may order any general partner or former general partner in the debtor that is not a debtor in a case under this title to provide the estate with indemnity for, or assurance of payment of, any such claim recoverable from the partner, or not to incur obligations or transfer property except as provided in the order.

"(e) An action or proceeding under this section may not be commenced after the earlier of—

"(1) four years after entry of the order for relief in the case concerning the partnership; and

"(2) the time the case is closed or dismissed.

"§565. Administrative expenses of a partnership case

"(a) Notwithstanding section 726(a) of this title, the court, after notice and a hearing, may order that an administrative expense allowed under section 503(b) of this title be paid, in such proportions as are fair and reasonable—

"(1) by a general partner or former general partner in the debtor, in addition to any recovery under section 564 of this title;

"(2) from any recovery from a partner under section 564 of this title; or

Page 126 PREV PAGE TOP OF DOC

"(3) from distributions from the estate otherwise payable to holders of claims or interests.

"(b) Payment of an administrative expense by a partner under subsection (a)(1) of this section shall be made to the trustee for distribution in accordance with section 566 of this title.

"§566. Distribution of property of partnership estate

"(a) Notwithstanding section 726(a) of this title, property of the estate recovered under section 564 or 565 of this section with respect to a general partner or former general partner or the value of such property shall be distributed only—

"(1) in payment of claims allowed in the case for which the partner is personally liable and for which there is insufficient other property of the estate to pay the claims in full; or

"(2) to the extent that the court, under section 565(a) of this title, orders payment with or from such property.

"(b) After notice and a hearing, the court shall determine, consistent with section 564(c) of this title, an equitable distribution of any property of the estate recovered under section 564 or 565 of this title and not distributed under subsection (a) of this section, and the trustee shall distribute the property or the value of the property according to the determination.

Page 127 PREV PAGE TOP OF DOC

"§567. Injunction against acts or proceedings against partners

"(a) After notice and a hearing, the court may enjoin—

"(1) an act, action, or proceeding to collect, assess, secure, or recover from a general partner or former general partner in the debtor on account of a claim against the debtor that arose before the commencement of the case; or

"(2) an act, action, or proceeding by a general partner or former partner in the debtor to collect, assess, secure, or recover from a general partner or former general partner in the debtor a claim arising out of or relating to the debts of the debtor that arose before the commencement of the case.

"(b) The court may not issue an injunction under subsection (a) of this section unless the terms and conditions of the injunction are fair and reasonable and—

"(1)(A) the injunction is contained in or issued with an order confirming a plan under section 1129 or 1225 of this title and—

"(i) the plan provides for payment in full of all claims against the debtor for which the partner protected by the injunction is liable under applicable nonbankruptcy law; or

"(ii) the protected partner has contributed or made an enforceable commitment to contribute to the payment of debts of the debtor for which the partner is liable under applicable nonbankruptcy law, in accordance with the plan or the order confirming the plan; or

Page 128 PREV PAGE TOP OF DOC

"(B) the injunction is issued in conjunction with settlement of a claim under section 564 of this title against the partner protected by the injunction and—

"(i) the case is a case under chapter 7 of this title; or

"(ii) there is good cause to approve the settlement and issue the injunction before confirmation of a plan;

"(2) the protected partner has paid any administrative expenses assessed against the partner under section 565 of this title; and

"(3) the injunction does not discriminate unfairly with respect to holders of claims against the debtor or claims of other general partners or former general partners against the protected partner arising out of or related to the partnership;

"(c) On request of a party in interest and after notice and a hearing, the court may, to the extent appropriate under the circumstances, revoke an injunction issued under subsection (a) of this section only if—

"(1) the injunction was procured by fraud and the request to revoke is made within two years after the entry of the order granting the injunction;

"(2) the injunction was issued under subsection (b)(1)(A)(i) of this section and the plan is not being performed in some material respect;

Page 129 PREV PAGE TOP OF DOC

"(3) the protected partner fails to perform a material obligation that the protected partner is obligated to perform under the plan, the order confirming the plan, or the injunction;

"(4) any other terms or conditions of or imposed by the court on the protected partner in connection with the injunction are not being performed or met in some material respect; or

"(5) the order confirming the plan in conjunction with which the injunction was issued is revoked under section 1144 or 1230 of this title.

"(d) If applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period for commencing or continuing an action other than in a bankruptcy court on a claim against the partner, the commencement or continuation of the action is enjoined under subsection (a) of this section, and the period has not expired before the issuance of the injunction, then the period does not expire until the later of—

"(1) the end of the period, including any suspension of the period occurring on or after the issuance of the stay; or

"(2) 30 days after notice of the revocation of the injunction with respect to the claim.".

(c) The table of sections for chapter 5 of title 11 of the United States Code is amended by adding at the end:

Page 130 PREV PAGE TOP OF DOC

(d) Section 103 of title 11 of the United States Code is amended by adding at the end:

"(j) Subchapter IV of chapter 5 of this title applies only in a case concerning a partnership, except that section 561 also applies in case concerning a partner.".

(e) Section 541(a) of title 11 of the United States Code is amended by inserting "564, 565" immediately after "553,".

Sec. 604. Repeal of the "Jingle Rule" in Partner Cases.

Chapter 5 of title 11 of the United States Code is amended by inserting immediately after section 510:

"§511. Partnership creditors of a debtor partner

Page 131 PREV PAGE TOP OF DOC

"(a) This section applies only in a case concerning a general partner or former general partner.

"(b) In this section, 'partnership creditor claim' means claim against a partnership in which the debtor is or was a partner for which the partnership and the debtor are both liable, other than any claim of a trustee under section 564(b) of this title, that arose before or at the time of the order for relief in the partnership case.

"(c) Notwithstanding any applicable rule or order of the court fixing a time within which proof of claim may be filed, but subject to section 564(e) of this title, a proof of claim asserting a claim under section 564(b) of this title may be filed at any time before the entry of the order approving the trustee's final report and final account in a case under chapter 7 of this title, or before the later of the last date permitted in the case for filing a proof of claim or the entry of an order of confirmation in a case under chapter 11, 12, or 13 of this title.

"(d) Notwithstanding section 502 of this title, there shall not be allowed a partnership creditor claim, except to any extent that the claim is allowable in the case and secured only by property of the partner and not by property of the partnership.

"(e) Any claim of the trustee against the debtor under section 564(b) of this title and any claim of a creditor of a partnership in which the debtor is or was a partner and for which the debtor is liable are entitled to the same treatment as any other claim against the debtor of the same or similar kind that is not a such a claim.".

Page 132 PREV PAGE TOP OF DOC

(b) The table of sections of chapter 5 of title 11 of the United States Code is amended by inserting immediately after the item relating to section 510:

"511. Partnership creditors of debtor partners.".

Sec. 605. Involuntary Petitions Against Partners.

Section 303(b) of title 11 of the United States Code is amended by redesignating paragraph (4) thereof as paragraph (5) and by inserting immediately before "or" at the end of paragraph (3):

"(4) if such person is a general partner or a former general partner in a partnership as to which relief has been ordered under this title, by the trustee of the partnership; or".

Sec. 606. Protection of Recovery of Claims Against Partners.

Section 362(b) of title 11 of the United States Code is amended by striking "or" after paragraph (18), striking the period at the end of paragraph (19) and inserting in lieu thereof "; or", and by adding at the end:

"(20) of any act, action, or proceeding with respect to which a stay may be issued under 563(a) of this title.".

Sec. 607. Nonrecourse Partnership Debts

Page 133 PREV PAGE TOP OF DOC

Section 1111(b) of title 11 of the United States Code is amended by adding at the end:

"(3) This subsection does not affect whether a partner is liable for a debt of a partnership.".

Sec. 608. Conforming Amendments.

(a) Section 502(a) of title 11 of the United States Code is amended to read:

"(a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner or former general partner in a partnership that is a debtor in a case of this title, objects.".

(b) Section 508(b) of title 11 of the United States Code is amended to read:

"(b) If a creditor of a partnership debtor receives, from a general partner or former general partner that is not a debtor in a case under this title, payment of, or a transfer of property on account of, a claim that is allowed under this title and that is not secured by a lien on property of the partner, then the creditor may not receive any distribution under this title on account of the claim until the value of the distribution under this title received by each of the other holders of claims on account of which the holders are entitled to share equally with the creditor under this title, as a percentage of the holders' allowed claims, equals the same percentage that the value of the payment or transfer received by the creditor from the partner is of the creditor's allowed claim.".

Page 134 PREV PAGE TOP OF DOC

(c) Section 548(b) of title 11 of the United States Code is amended to read:

"(b) The trustee of a partnership debtor may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if, on the date the transfer was made or the obligation was incurred, the transferee was a general partner in the debtor and the debtor was insolvent or became insolvent as a result of the transfer or obligation.".

(d) Section 1141(a) of title 11 of the United States Code is amended to read:

"(a) Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner or former general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or partner is impaired under the plan and whether or not such creditor, equity security holder, or partner has accepted the plan.".

(e) Section 1141(c) of title 11 of the United States Code is amended to read:

"(c) Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and general partners and former general partners in the debtor.".

Page 135 PREV PAGE TOP OF DOC

(f) Section 1227(a) of title 11 of the United States Code is amended to read:

"(a) Except as provided in section 1228(a) of this title, the provisions of a confirmed plan bind the debtor, each creditor, each equity security holder, and each general partner and former general partner in the debtor, whether or not the claim or interest of such creditor, such equity security holder, or such partner is provided for by the plan, and whether or not such creditor, such equity security holder, or such partner has objected to, has accepted, or has rejected the plan.".

APPENDIX B: SECTION BY SECTION ANALYSIS OF PROPOSED PARTNERSHIP AMENDMENTS

Sec. 602. Definitions.

Section 602 amends various definitions in 11 U.S.C. §101 to define currently undefined terms and to implement the new provisions being proposed by other by other sections of Title VI. For example, section 602 adds definitions of "partner," "general partner" and "former general partner," and amends the definition of "insolvent" for partnerships to take into account the assets of current and former general partners available to pay partnership debts.

COMMENTS. These definitions are designed to minimize litigation and provide a comprehensive framework for dealing with the partners of partnerships in bankruptcy.

Page 136 PREV PAGE TOP OF DOC

Sec. 603. Treatment of partnerships in bankruptcy.

This section repeals 11 U.S.C. §723, which deals with the rights of a chapter 7 partnership trustee against general partners, and replaces it with a set of new provisions applicable in partnership bankruptcies under chapters 7, 9, 11 and 12.

COMMENTS. Section 603 recognizes that the unique attributes of the partnership form require some special provisions to ensure the fair and consistent treatment of partnerships, partners and their creditors when a partnership is in bankruptcy.

11 U.S.C. §561

A new 11 U.S.C. §561 invalidates *ipso facto* clauses that purport to dissolve, terminate or modify a partnership in bankruptcy based on insolvency or financial condition.

COMMENTS. This provision is derived from and consistent with other sections of the Bankruptcy Code (see, e.g., §541(c)(1) and 365(b)(2) & (e)(1)) that render these clauses unenforceable in other contexts in order to ensure that parties cannot circumvent the collective bankruptcy proceeding through private agreements. Under the amendment to 11 U.S.C. §103 made by section 603(d), this provision will apply in a case concerning a partner or partnership.

11 U.S.C. §562

Page 137 PREV PAGE TOP OF DOC

A new 11 U.S.C. §562 mandates financial disclosures by general partners and former general partners. This information is available to parties in interest unless confidentiality concerns require otherwise.

COMMENTS. To the extent that a partner is liable for partnership debts, his financial profile is directly relevant to partnership creditors and to the conduct of the bankruptcy case and, thus, should be made available.

11 U.S.C. §563

A new 11 U.S.C. §563 enables a court in a partnership bankruptcy case to enjoin actions against a partner to collect partnership-related debts for cause. However, injunctive relief is available only if the partner consents to bankruptcy court jurisdiction, makes adequate disclosures and complies with other court orders regarding incurring debts and transferring property. Relief from this injunction may be obtained for cause.

COMMENTS. The availability of such temporary injunctions maximizes the effectiveness of the collective bankruptcy case for the partnership.

11 U.S.C. §564

As a replacement for 11 U.S.C. §723, a new 11 U.S.C. §564 provides the trustee for a partnership debtor under any chapter of the Bankruptcy Code with a claim against current and former general partners to recover any deficiency in the partnership estate to cover claims for which such partners are liable. The court may require the partners to provide assurance of payment of such claims. However, this section imposes a time limit on the trustee's deficiency claim actions to provide reasonable closure for the partners. Under this provision, general partners may be held liable for partnership debts in the partnership case to the extent they would be liable under applicable nonbankruptcy law.

Page 138 PREV PAGE TOP OF DOC

COMMENTS. This provision provides a framework for the marshaling of available resources for the payment of creditors.

11 U.S.C. §565

Under a new 11 U.S.C. §565, a current or former general partner may be required to pay administrative expense claims in the partnership bankruptcy case in proportions that are fair and reasonable. Under this provision, administrative costs also could be assessed against recoveries from partners that would otherwise be paid to creditors entitled to receive those recoveries.

COMMENTS. Some large partnership cases have produced significant disputes over liability for expenses of administration of the partnership bankruptcy case. Since partners benefit from the collective proceeding, it may be appropriate to assess administrative costs against them. Court involvement protects partners from automatically being required to cover excessive expenses incurred by a creditors' committee.

11 U.S.C. §566

A new 11 U.S.C. §566 ensures that recoveries from partners are applied to administrative claims, as ordered by the court, and to prepetition claims on which a partner is personally liable if property of the partnership bankruptcy estate is insufficient to pay the claims in full.

Page 139 PREV PAGE TOP OF DOC

COMMENTS. This provision harmonizes bankruptcy law with partnership law.

11 U.S.C. §567

Under a new 11 U.S.C. §567, the court in a partnership bankruptcy case is authorized to enjoin future collection actions against a non-debtor partner if the non-debtor partner has contributed to the plan of reorganization or made an enforceable commitment to contribute to payment of the partnership debts, or if the plan provides for payment in full of all claims on which the partner is liable. Likewise, a court may enjoin future actions against a non-debtor partner in the context of a settlement agreement in a chapter 7 case. In any case, the terms and conditions of the injunction must be fair and reasonable, the partner must have paid all administrative expenses assessed against him, and the injunction may not be unfairly discriminatory. Section 567 creates a procedure for revocation of non-debtor injunctions in appropriate cases.

COMMENTS. This new section helps to resolve an open legal question regarding the ability of a court or plan of reorganization to release non-debtor parties from liabilities. Often, all parties would be better served if claims against non-debtor partners were effectively released when those partners help fund a partnership's plan of reorganization or in some other fashion contribute to pay claims in a collective proceeding, rather than if partnership creditors were required to pursue liable partners on an individual basis under state law.

Sec. 604. Repeal of the "Jingle rule" in partner cases.

Page 140 PREV PAGE TOP OF DOC

Under a new 11 U.S.C. §511, in the bankruptcy case of a current or former general partner, partnership claims are not subordinated to nonpartnership claims against the partner. Instead, these two kinds of claims have equal priority and share pro rata.

COMMENTS. This provision is consistent with the distribution mandated in current 11 U.S.C. §723(c), but is applicable in all chapters, not just in chapter 7.

Sec. 605. Involuntary petitions against partners.

Section 605 amends 11 U.S.C. §303(b), enabling a partnership trustee to file involuntary petitions against current and former general partners that are liable to partnership creditors. Although the trustee's standing to file an involuntary is not dependent on the number of creditors or the nature or amount of the claims that the trustee represents, other safeguards in section 303 remain applicable.

COMMENTS. This amendment permits the trustee to act on a collective basis to protect the interests of the partnership creditors to whom partners are liable.

Sec. 606. Protection of recovery of claims against partners.

This section clarifies that in a partnership case, the automatic stay of 11 U.S.C. §362(a) does not enjoin actions against non-debtor partners on partnership-related debts.

Page 141 PREV PAGE TOP OF DOC

COMMENTS. Any injunction protecting non-debtor partners in a partnership case is governed by the new 11 U.S.C. §563.

Sec. 607. Nonrecourse partnership debts.

Section 607 amends 11 U.S.C. §1111(b) to clarify that the transformation of nonrecourse claims into recourse claims against the partnership debtor for purposes of its chapter 11 plan does not make the claims recourse as to partners.

COMMENTS. This amendment codifies the conclusion properly reached by the courts that have addressed this matter under current law.

Sec. 608. Conforming Amendments.

This section contains a variety of conforming and clarifying amendments. For example, it amends 11 U.S.C. §502(a) so that creditors of former general partners, as well as creditors of current general partners, may object to claims in partnership cases. Likewise, it amends 11 U.S.C. §1141 and 1227 to include references to former general partners.

COMMENTS. These amendments complement the aforementioned proposed changes in title VI of this bill.

APPENDIX C: PROPOSED PROVISIONS TO PROTECT MASS FUTURE CLAIMS IN BANKRUPTCY CASES

Page 142 PREV PAGE TOP OF DOC

Sec. 701. Short Title.

This title may be cited as the "Mass Future Claims Protection Act".

Sec. 702. Definition of Mass Future Claim.

(a) Section 101 of title 11 of the United States Code is amended by inserting in alphabetical order the following new definition—

"( ) 'mass future claim' means one of a group of claims—

"(A) against the debtor;

"(B) that have arisen by reason of an act, an omission, conduct, or a status (such as ownership of property) of the debtor that—

"(i) occurred before the date of the filing of the petition; and

"(ii) has been, and is likely to be, sufficient to establish liability of the debtor when an injury ultimately occurs or is manifested;

"(C) the injury giving rise to which has not been manifested as of the date of the filing of the petition to the point where the holder of such a claim knows or reasonably should have known of the injury;

Page 143 PREV PAGE TOP OF DOC

"(D) that arose from the same cause, origin, or nature of injury or acts, omissions, conduct or status of the debtor as claims for which the debtor has been subject, as of the date of the filing of the petition, to demands for payment; and

"(E) for which the debtor is likely to be subject to numerous future demands for payment on similar grounds;

"(F) the holders of which can be identified or described with reasonable certainty; and

"(G) the amount of which, in the aggregate, and the number of holders of which are reasonably capable of estimation;".

(b) Section 101 of title 11 of the United States Code is amended by renumbering each definition consecutively starting from (1).

Sec. 703. Mass Future Claims Representative.

(a) Chapter 5 of title 11 of the United States Code is amended by inserting immediately after section 510 the following—

"§511. Future claims representative

"(a) In a case under chapter 7 of this title, at any time after the order for relief but before the last day for filing proofs of claims, on request of a party in interest or the United States trustee, and after notice and a hearing, the court may order the appointment of a representative of holders of mass future claims.

Page 144 PREV PAGE TOP OF DOC

"(b) In a case under chapter 9 or 11 of this title, at any time after the order for relief but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court—

"(1) may order the appointment of a representative of holders of mass future claims if the appointment is in the best interest of the estate; and

"(2) shall order the appointment of a representative of holders of mass future claims if it appears that a plan that impairs a class containing mass future claims has been or might be proposed.

"(c) For cause, including differences as to the cause, origin, or nature of injury or as to the acts, omissions, conduct or status of the debtor that gave rise to future claims, the court may order the appointment of more than one representative of holders of mass future claims. If the court orders the appointment of more than one representative, the court shall specify the kinds of mass future claims whose holders each representative represents.

"(d) For each representative that the court orders appointed under this section, the United States trustee, after consultation with parties in interest, shall appoint, subject to the court's approval, one disinterested individual that does not hold or represent an interest adverse to the interests of the holders of the mass future claims to serve as the representative.

"(e) A representative appointed under this section may file a proof of claim on behalf of the holders of mass future claims that the representative represents. The proof of claim may assert the aggregate amount of liability and number of holders of mass future claims of the kind represented.

Page 145 PREV PAGE TOP OF DOC

"(f) For cause, to the extent authorized by the court, a representative appointed under this section may exercise the powers and duties of a committee set forth in section 1103 of this title, but the court may not authorize a representative appointed to a committee under section 1102(c) of this title to perform any of the activities of a committee specified in section 1103(c) except to the extent that parties in interest in the case generally may perform the activities.

"(g) If the court has ordered the appointment of a representative under subsection (a) of this section, then notwithstanding the appointment of the representative, a holder of a mass future claim that would be represented by the representative may elect not to be so represented. If the holder elects not to be represented, the holder may file a proof of claim, accept or reject a plan, and participate in the case in the same manner and to the same extent as a holder of a claim that is not a mass future claim.

"(h) A representative appointed under this section is subject to suit only to the same extent that a trustee appointed in the case would be subject to suit. After notice and a hearing, the trustee, subject to the court's approval, may indemnify, and a plan may provide for indemnification of, a representative appointed under this section against claims arising out of the representative's service. Indemnification under this subsection may be provided from property of the estate or from any fund established for the benefit of holders of mass future claims that the representative represents.

"(i) The court, after notice and a hearing, may remove a representative appointed under this section for cause.".

Page 146 PREV PAGE TOP OF DOC

(b) The table of sections for chapter 5 of title 11 of the United States Code is amended by inserting immediately after the item relating to section 510 the following—

"511. Future claims representative.".

(c) Section 1102 of title 11, United States Code is amended by adding at the end thereof the following—

"(d) On request of a representative appointed under section 511 of this title, the United States trustee may appoint the representative to a committee appointed under this section.".

Sec. 704. Estimation of Mass Future Claims.

Section 502(c) of title 11 of the United States Code is amended to read as follows—

"(c) There shall be estimated for purpose of allowance under this section—

"(1) any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case;

Page 147 PREV PAGE TOP OF DOC

"(2) any right to payment arising from a right to an equitable remedy for breach of performance; or

"(3) the aggregate amount and number of holders of any group of mass future claims represented by a representative appointed under section 511 of this title.".

Sec. 705. Authorization of Channeling Injunctions.

(a) Subsections (g) and (h) of section 524 of title 11, United States Code, are repealed, but this repeal does not affect the application of those subsections to any case under title 11, United States Code, that was commenced before the date of enactment of this Act.

(b) Section 524 of title 11 of the United States Code is amended by adding at the end thereof:

"(g) Notwithstanding subsection (e) of this section, a discharge may enjoin an act, action, or proceeding to collect, assess, secure, or recover from an entity other than the debtor mass future claims or claims for injury that are not mass future claims but that arise from the same single or a related series of acts, omission, conduct, or status of the debtor as the mass future claims, if—

"(1) the mass future claims have been allowed in the case;

"(2) a representative of holders of the mass future claims has been appointed under section 511 of this title; and

Page 148 PREV PAGE TOP OF DOC

"(3) in a case under chapter 9 or 11 of this title, the plan provides for the mass future claims and for the injunction.".

(b) Section 901 of title 11 of the United States Code is amended by inserting "524(g)," immediately after "524(a)(2),".

Sec. 706. Sale of Assets Free and Clear of Mass Future Claims.

(a) Section 363 of title 11 of the United States Code is amended by adding at the end thereof—

"(p) If a representative of holders of mass future claims has been appointed under section 511 of this title, the trustee may sell property under subsection (b) of this section free and clear of the mass future claims. The court may enjoin an act, action, or proceeding to collect, assess, secure, or recover from the property of from the purchaser of the property the mass future claims or claims for injury that are not mass future claims but that arise from the same single or a related series of acts, omission, conduct, or status of the debtor as the mass future claims.".

(b) Section 1123(b) of title 11 of the United States Code is amended by redesignating paragraph (6) thereof as paragraph (7) and by inserting immediately before "and" at the end of paragraph (5) the following—

"(6) if a representative of the holders of the mass future claims has been appointed under section 511 of this title, provide for the sale of property of the estate free and clear of the mass future claims;".

Page 149 PREV PAGE TOP OF DOC

Sec. 707. Separate Classification of Mass Future Claims in a Chapter 11 Plan.

Section 1122 of title 11 of the United States Code is amended by adding at the end thereof the following—

"(d) A plan may designate a class of mass future claims that is separate from other classes of claims and may place mass future claims in the class only if the mass future claims are substantially similar to the other mass future claims of the class. If there is a different cause, origin, or nature of injury or act, omission, conduct or status of the debtor that gave rise to different kinds of mass future claims, a plan may designate more than one class of mass future claims.".

Sec. 708. Conforming Amendments for Mass Future Claims Representative.

(a) Section 501(a) of title 11 of the United States Code is amended to read as follows:

"(a) A creditor, an indenture trustee, or a mass future claims representative may file a proof of claim. An equity security holder or a general partner may file a proof of interest.".

(b) Section 1109(b) of title 11 of the United States Code is amended by inserting "mass future claims representative," immediately after "equity security holder,".

Page 150 PREV PAGE TOP OF DOC

(c) Section 1121(c) of title 11 of the United States Code is amended by inserting "mass future claims representative," immediately after "equity security holder,".

(d) Section 1125(b) and (c) of title 11 of the United States Code is amended to read as follows—

"(b) An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to the claim or interest or from a mass future claims representative, unless, at the time of or before the solicitation, there is transmitted to the holder or representative the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information. The court may approve a disclosure statement without a valuation of the debtor or an appraisal of the debtor's assets.

"(c) The same disclosure statement shall be transmitted to each holder or mass future claims representative of a claim or interest of a particular class, but there may be transmitted different disclosure statements, differing in amount, detail, or kind of information, as between classes.".

(e) Section 1126 of title 11 of the United States Code is amended by adding at the end thereof the following—

"(h) For purposes of subsection (c) of this section, the amount of a claim of a representative appointed under section 511 of this title who files a proof of claim under section 511(f) of this title is the aggregate allowed amount of mass future claims of holders that the representative represents, and the number of claims is the actual or estimated number of holders that the court determines the representative represents.".

Page 151 PREV PAGE TOP OF DOC

Sec. 709. Subordination of Penalty Claims.

(a) Section 1122 of title 11 of the United States Code is amended by adding at the end thereof—

"(d) A plan may designate a separate class of claims consisting only of every unsecured claim of a kind specified in section 726(a)(4) of this title. If a plan provides for the liquidation of all or substantially all of the property of the estate and the debtor is not to engage in business after consummation of the plan, the plan shall designate such a separate class.".

(b) Section 1123(a)(4) of title 11 of the United States Code is amended to read as follows—

(4) provide—

"(A) the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest; and

"(B) for the subordination of all claims of any class designated under section 1122(d) of this title to all other claims;".

(c) Section 726(a)(4) of title 11 of the United States Code is amended to read as follows—

Page 152 PREV PAGE TOP OF DOC

"(4) fourth, in payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss;".

APPENDIX D: SECTION BY SECTION ANALYSIS OF PROPOSED PROVISIONS TO PROTECT MASS FUTURE CLAIMS IN BANKRUPTCY

Sec. 702. Definition of mass future claim.

This section introduces a definition of mass future claims into the Bankruptcy Code that will be used in the following sections. Although separately numbered, mass future claim is a subset of claim. Specific requirements must be satisfied to receive this special designation. A claim may be a mass future claim if the alleged prepetition conduct of the debtor is sufficient to establish liability when injuries ultimately are manifested, the debtor has been subject to demands for payment on the same grounds and likely to be subject to numerous grounds in the future, the holders of such claims can be described with reasonable certainty (but not specifically identified), and the claims in aggregate are reasonably capable of estimation.

COMMENTS. Although the definition of ''claim'' already includes contingent, unmatured, and unliquidated claims, some courts will not permit contingent obligations to be treated as prepetition claims if the cause of action has not accrued under state law, and therefore prevent a debtor from dealing with all claims in a collective and efficient fashion. See Avellino & Bienes v. M. Frenville Co. (In re M. Frenville Co.), 744 F.2d 332 (3d Cir. 1984). The proposed definition of mass future claims rejects the rigid Frenville analysis and instead is consistent with the view that inchoate claims based on prepetition conduct may be treated as prepetition claims, assuming that due process, notice, and substantive requirements of title 11 are satisfied. Including mass future claims in the bankruptcy process promotes equality of treatment and maximizes value for all creditors, including mass future claim holders.

Page 153 PREV PAGE TOP OF DOC

The mass future claims definition channels a narrow band of future claims into specific treatment and is not meant to broaden or to narrow the definition of ''claim,'' which already is sufficiently broad to include future claims, although other factors apart from the definition—(e.g., due process, notice, or the other mass future claims amendments) may make it improper to treat a particular group of claims collectively.

Sec. 703. Mass future claims representative.

This section adds a new 11 U.S.C. §511 that governs mass future claims representatives. A court may order the appointment of one or more disinterested mass future claims representative in a case under chapter 7, 9, or 11. This representative files a proof of claim on behalf of the holders of mass future claims and exercises the powers and duties of a creditors' committee. A claim holder is entitled to opt out of representation, and instead can pursue her own interests. This section also specifies the circumstances in which a representative is personally liable for his conduct.

COMMENTS. Absent statutory authority, courts have struggled to ensure adequate representation and protection for the inchoate interests of future claims holders. By expressly authorizing the appointment of mass future claims representatives and delineating the obligations of those representatives, this provision gives clear and consistent protection to the holders of mass future claims.

Sec. 704. Estimation of mass future claims.

Page 154 PREV PAGE TOP OF DOC

This provision amends 11 U.S.C. §502(c) expressly to permit aggregate estimation of the amount and number of holders of mass future claims.

COMMENTS. This provision allows the bankruptcy court to estimate the aggregate amount of mass future claims, so that a chapter 7 trustee distributing the assets of the estate or a chapter 9 or 11 plan may set aside an adequate fund from which the individual claims may be paid when allowed. This provision is not intended to override 11 U.S.C. §157(b)(2)(B) or 157(b)(5) of title 28, which require that the district court determine individual personal injury or wrongful death tort claims. Those sections should be addressed directly, as recommended in Title III of this bill. Although this amendment does not specify that the estimation is for purposes of distribution, estimation leads to claim allowance and aggregate distribution on those claims will necessarily follow.

Sec. 705. Authorization of channeling injunctions.

Section 705 repeals the "asbestos amendments" that were enacted in the Bankruptcy Reform Act of 1994, but cases currently operating under the asbestos amendments will not be affected. For future cases, section 705 authorizes courts to issue injunctions in cases involving any type of mass future claims. These injunctions may direct claimants toward a pool of assets or funds and channel those claimants away from the reorganized entity or other nondebtor parties.

COMMENTS. This amendment provides generically what the asbestos amendments provided specifically for asbestos cases. To increase the amount of assets available for payment of claimants, the court should be empowered to protect parties that have contributed to the payment of mass future claims.

Page 155 PREV PAGE TOP OF DOC

Sec. 706. Sale of assets free and clear of mass future claims.

Section 706 allows property of the estate to be sold free and clear of claims that have been treated in accordance with the proposed mass future claims provisions.

COMMENTS. Section 363 of the Bankruptcy Code already permits property to be sold free and clear of liens, but does not expressly provide for sales free and clear of unsecured claims. This provision gives good faith buyers protection from mass future claims when those claimants are being repaid through a fund or trust. By providing certainty and reducing risk, this protection should increase the purchase price of estate assets, ultimately yielding greater compensation of claimants.

Sec. 707. Separate classification of mass future claims in a chapter 11 plan.

This section amends 11 U.S.C. §1122 expressly to permit, but not require, mass future claims to be classified separately in one or more classes apart from other classes of general unsecured claims.

COMMENTS. To avoid litigation and complication, this provision makes explicit the authorization for separate classification of mass future claims. This amendment does not speak to the questions whether similar claims can be classified separately or whether future claims are dissimilar to other claims.

Sec. 708. Conforming amendments for mass future claims representative.

Page 156 PREV PAGE TOP OF DOC

This section adds references to "mass future claims representative" in a variety of existing statutory provisions.

COMMENTS. This provision makes necessary conforming amendments.

Sec. 709. Subordination of penalty claims.

This section permits the separate classification and subordination of penalty claims, and requires that penalty claims be subordinated in liquidating plans.

COMMENTS. Subordination of noncompensatory penalty claims is consistent with the general subordination of such claims elsewhere in the bankruptcy system to maximize distributions for claimholders who have suffered actual loss.

APPENDIX E: SMALL BUSINESS AND FAMILY FARMER CASES (REVISED SMALL BUSINESS PROVISIONS PROPOSED BY THE COMMERCIAL LAW LEAGUE OF AMERICA AND THE NATIONAL BANKRUPTCY CONFERENCE)

SUBTITLE I—SIMPLIFICATION OF SMALL BUSINESS CASES

Sec. 201. Short Title.

This title may be cited as the "Small Business Bankruptcy Simplification Act".

Page 157 PREV PAGE TOP OF DOC

Sec. 202. Small Business Defined.

(a) Section 101 of title 11, United States Code, is amended by striking paragraph (51C) and inserting:

"(51C) 'small business case' means case filed under chapter 11 of this title in which the debtor is engaged in a business that has fixed, liquidated debts as of the date of the filing of the petition of $2,000,000 or less (excluding any debt owed to an insider), unless the debtor is a member of a group of affiliates that have in the aggregate fixed, liquidated debts greater than $2,000,000 (excluding any debt owed to an insider).

(b) Conforming Amendment. Section 1102(a)(3) of title 11, United States Code, is amended by deleting "a case in which the debtor is" and inserting "case" after "small business".

Sec. 203. Flexible Rules for Disclosure Statements and Plans.

(a) Section 1125(f) of title 11, United States Code, is amended to read as follows:

"(f) Notwithstanding subsection (b) of this section—

"(1) in determining whether a disclosure statement contains adequate information, the court shall consider the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing additional information; and

Page 158 PREV PAGE TOP OF DOC

"(2) in a small business case, the court may approve a disclosure statement submitted on standard forms approved by the court or adopted under section 2075 of title 28.

(b) Section 1125 of title 11, United States Code, is amended by adding at the end thereof:

"(g) Notwithstanding subsection (b) of this section, in a small business case—

"(1) the court may conditionally approve a disclosure statement subject to final approval after notice and a hearing;

"(2) an acceptance or rejection of a plan may be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to the claim or interest, if, at the time of or before the solicitation, there is transmitted to such holder a written disclosure statement, conditionally approved by the court as containing adequate information; and

"(3) a hearing on final approval of a disclosure statement may be combined with the hearing on confirmation of the plan.".

Sec. 204. Standard Form Disclosure Statement and Plan and Uniform Reporting Rules and Forms.

Page 159 PREV PAGE TOP OF DOC

Section 2075 of title 28, United States Code, is amended by adding at the end thereof:

"The Supreme Court shall have the power to prescribe by general rules, for use in small business cases under title 11, the forms of plans and disclosure statements and, for use in small business cases and cases under chapter 12 of title 11, rules and the forms to be used to comply with sections 1115 and 1209 of title 11, United States Code. Any such forms and rules shall be designed to satisfy the needs of the court, the United States trustee or bankruptcy administrator, creditors, and other parties in interest for adequate information, while seeking to achieve economy and simplicity for the debtor.".

Sec. 205. Duties and Uniform National Reporting Requirements in Small Business Cases.

(a) Duties and Required Reporting. (1) Title 11 of the United States Code is amended by inserting after section 1114 the following:

"§1115. Duties of debtor in possession in a small business case

"(a) This section applies only in a small business case.

"(b) A debtor in possession shall—

"(1) within three days after the date of the order for relief under this chapter, file a statement, verified by the debtor in possession and by any counsel employed or proposed to be employed under section 327 of this title, that the debtor has been informed of the duties and responsibilities of a debtor in possession;

Page 160 PREV PAGE TOP OF DOC

"(2) within 20 days after the date of the order for relief under this chapter, transmit to the United States trustee—

"(A) a copy of the debtor's most recent Federal income tax return, which the United States Trustee shall make available, on request, to a party in interest for inspection only ; and

"(B) any balance sheet, income statement and statement of cash flows for the debtor prepared on a monthly or, if not available, quarterly basis within one year before the date of the order for relief, which the United States Trustee shall make available, on request, to any party in interest, or if any such document does not exist, a verified statement that the document does not exist,;

"(3) attend, through management and with counsel, any initial debtor interview, scheduling conference, confirmation hearing, meeting of creditors under section 341 of this title and any other meeting or hearing if so ordered by the court;

"(4) file all schedules and statements of financial affairs within the time required, without extension, under the Federal Rules of Bankruptcy Procedure, unless the court extends the time to not more than 30 days after the date of the order for relief under this chapter, or, if there is a reasonable justification, a later time;

"(5) timely file periodic reports that provide the following information—

Page 161 PREV PAGE TOP OF DOC

"(A) the debtor's receipts and disbursements for the fiscal periods specified by the Federal Rules of Bankruptcy Procedure;

"(B) whether the debtor is in material compliance with all postpetition requirements imposed by this title and the Federal Rules of Bankruptcy Procedure;

"(C) whether the debtor has timely filed all tax returns and paid all administrative claims when due, and, if not, what the failures are and how, at what cost, and when the debtor intends to remedy such failures; and

"(D) such other information as the court determines is needed in the best interest of the debtor and creditors and in the public interest in fair and efficient procedures under this chapter.

"(6) timely file all other reports required by the Federal Rules of Bankruptcy Procedure or by local rule;

"(7) to the extent commercially practicable, maintain insurance customary for the kind of business in which the estate is engaged after the date of the order for relief under this chapter;

"(8)(A) timely file all tax returns required for the estate;

"(B) timely pay all administrative expense tax claims, except claims being contested by appropriate proceedings being diligently prosecuted; and

Page 162 PREV PAGE TOP OF DOC

"(C) establish a separate deposit account not later than ten business days after the date of the order for relief under this chapter (or as soon as possible after the ten-day period if during the ten-day period all banks contacted decline to open the necessary account) and deposit in the account, not later than five business days after receipt, all taxes collected or withheld for a governmental unit;

"(9) timely pay all administrative wage claims; and

"(10) allow the United States trustee to inspect the business premises, books, and records of the debtor in possession at reasonable times, after reasonable prior written notice, unless the debtor in possession waives notice.".

(b) Conforming Amendment.—The table of sections of chapter 11 of title 11, United States Code, is amended by inserting after the item relating to section 1114 the following:

"1115. Duties of a debtor in possession in a small business case.".

Sec. 206. Plan Filing Deadline.

Section 1121(e) of title 11, United States Code, is amended to read as follows:

"(e) In a small business case—

Page 163 PREV PAGE TOP OF DOC

"(1) unless a trustee has been appointed, only the debtor may file a plan until 90 days after the date of the order for relief under this chapter;

"(2) all plans shall be filed within 160 days after the date of the order for relief; and

"(3) on request of a party in interest made within the respective periods specified in paragraphs (1) and (2), and after notice and a hearing, the court may—

"(A) reduce the 90-day period or the 160-day period specified in paragraph (1) or (2) of this subsection for cause;

"(B) increase the 90-day period specified in paragraph (1) of this subsection for cause; and

"(C) increase the 160-day period specified in paragraph (2) of this subsection, after notice and a hearing, if to do so would be in the best interest of creditors and the estate.".

Sec. 207. Duties of the United States Trustee and Bankruptcy Administrator.

(a) Duties of the United States Trustee. Section 586(a) of title 28, United States Code, is amended—

Page 164 PREV PAGE TOP OF DOC

(1) in paragraph (3)—

(A) in subparagraph (G) by striking "and" at the end;

(B) by redesignating subparagraph (H) as subparagraph (K); and

(C) by inserting after subparagraph (G) the following:

"(H) in small business cases (as defined in section 101 of title 11), scheduling and holding such meetings with the debtor in possession, at such places as the United States trustee considers appropriate, as may be reasonably necessary to permit the United States trustee to assess the debtor in possession's compliance with the duties and responsibilities of a debtor in possession under title 11 and whether there are material grounds for conversion or dismissal of the case under section 1112 of title 11;

"(I) visiting the appropriate business premises of the debtor in possession and ascertaining the state of the debtor in possession's books and records and verifying that the debtor has filed any required tax returns; and

"(J) in cases in which the United States trustee finds cause for conversion or dismissal under section 1112 of title 11, requesting conversion or dismissal; and".

(b) DUTIES OF THE BANKRUPTCY ADMINISTRATOR.—A bankruptcy administrator appointed under section 302(d)(3)(I) of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986 (Pub. L. 99–554, 100 Stat. 3123), as amended by section 317(a) of the Federal Courts Study Committee Implementation Act of 1990 (Public Law 101–650; 104 Stat. 5115), or the bankruptcy administrator's designee, in a small business case (as defined in section 101 of title 11 of the United States Code) pending in the district for which the bankruptcy administrator has been appointed, shall perform the duties specified in section 586(a)(3)(H), (I), and (J) of title 28 of the United States Code, and the debtor shall transmit to the bankruptcy administrator any information that the debtor is required to transmit to the United States trustee under section 1115(b) or 1209 of title 11.

Page 165 PREV PAGE TOP OF DOC

Sec. 208. Scheduling Conferences.

Section 105(d) of title 11, United States Code, is amended—

(1) by striking out everything through paragraph (1) and inserting in lieu thereof:

"As soon as practicable after the date of the order for relief, the court—

"(1) in a small business case or a case under chapter 12 of this title shall, and on its own motion or on request of a party in interest in any other case under this title may, hold an initial status conference and such additional status conferences as are necessary to further the expeditious and economical resolution of the case and may direct that a status conference in a case under chapter 12 of this title be held with the standing trustee; and"; and

(2) in paragraph (2) by inserting "may, on its own motion or on request of a party in interest," immediately after "Procedure,".

Sec. 209. Serial Filer Provisions.

Section 362 of title 11, United States Code, is amended by adding at the end:

Page 166 PREV PAGE TOP OF DOC

"(k)(1) Notwithstanding any other provision in this section, the filing of a petition under section 301 of this title or of a collusive petition under section 303 of this title does not operate as a stay if and only if—

"(A) the debtor is a debtor in a case under chapter 11 or 12 of this title that is pending at the time the petition is filed; or

"(B) the case is a case under chapter 11 or 12 of this title and the debtor—

"(i) was a debtor in a case under chapter 11 or 12 of this title that was dismissed for any reason other than excusable neglect by an order that became final within two years before the date of the filing of the petition;

"(ii) was a debtor in a case under chapter 11 or 12 of this title in which a plan was confirmed within two years before the date of the filing of the petition; or

"(iii) has succeeded to substantially all of the assets or business of a debtor described in subparagraph (B) or (C) of this paragraph and was, at the time of the prior debtor's case, an insider of the debtor.

"(2) In a case that is subject to this subsection—

"(A) if the case is the first case in which the provisions of this subsection apply to the debtor or insider successor to the debtor, then the petition shall operate as a stay under subsection (a) of this section for 15 days after the date of the filing of the petition; and

Page 167 PREV PAGE TOP OF DOC

"(B) on request of a party in interest, after notice and a hearing, the court may issue or extend a stay, subject to such conditions as may be appropriate under the circumstances, if the court determines based on a preponderance of the evidence that the circumstances leading to the filing of the petition were not reasonably foreseeable at the time of the dismissal or confirmation, as the case may be, of the prior case, and that there is a reasonable likelihood that the debtor will file a plan that meets the requirement of section 1129 or 1225 of this title, as the case may be. Subsections (c), (d), (e), (f), (g), and (h) of this section apply to any stay issued under this paragraph.".

Sec. 210. Conversion or Dismissal of a Chapter 11 Case.

(a) Section 1112(b) of title 11, United States Code, is amended to read as follows:

"(b) Except as provided in subsection (c) of this section, on request of a party in interest or the United States trustee or bankruptcy administrator, and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, including—

"(1) unreasonable delay or gross mismanagement by the debtor that is prejudicial to creditors;

"(2) nonpayment of any fees or charges required under chapter 123 of title 28;

Page 168 PREV PAGE TOP OF DOC

"(3) failure to file a plan and disclosure statement within any time fixed under section 1121 of this title or by the court;

"(4) inability to effectuate substantial consummation of a confirmed plan;

"(5) denial of or failure to seek confirmation of a plan within any time fixed under section 1121 of this title or by the court and denial of a request made for additional time for filing another plan or a modification of a plan;

"(6) material default by the debtor with respect to a confirmed plan;

"(7) revocation of an order of confirmation under section 1144 of this title, and denial of confirmation of another plan or a modified plan under section 1129 of this title;

"(8) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan;

"(9) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;

"(10) in a voluntary case, the debtor's failure to file, within fifteen days after the filing of the petition commencing such case or such additional time as the court may allow, the information required by paragraph (1) of section 521, including a list containing the names and addresses of the holders of the twenty largest unsecured claims (or of all unsecured claims if there are fewer than twenty unsecured claims), and the approximate dollar amounts of each of such claim;

Page 169 PREV PAGE TOP OF DOC

"(11) material failure to comply with any applicable reporting requirements of section 1115 of this title;

"(12) failure by a debtor in possession to attend the meeting of creditors under section 341(a) of this tile or an examination ordered under Rule 2004 of the Federal Rules of Bankruptcy Procedure;

"(13) unauthorized use of cash collateral in disregard of the requirements of this title, causing material harm to one or more creditors; or

"(14) material failure of the debtor in possession to comply with a material order of the court.".

(b) Section 1112 of title 11, United States Code, is amended by striking subsection (e) and redesignating subsection (f) as subsection (e).

SUBTITLE II—CORRESPONDING AMENDMENTS FOR FAMILY FARMER CASES

Sec. 221. Short Title

This title may be cited as the "Family Farmer Bankruptcy Simplification Act—.

Sec. 222. Retention of Attorneys for the Debtor.

Page 170 PREV PAGE TOP OF DOC

Section 327(a) of title 11, United States Code, is amended by inserting "or the debtor in possession in a case under chapter 12 of this title," after "in this section, the trustee,".

Sec. 223. Duties of Trustee.

Section 1202(5) of title 11, United States Code, is amended by deleting "and" and inserting and ", and 1209" after "1203".

Sec. 224. Duties and Uniform National Reporting Requirements in Family Farmer Cases.

(a) Duties and Required Reporting. (1) Title 11, United States Code, is amended by inserting after section 1208 the following:

"§1209. Duties of debtor in possession in chapter 12 case

"A debtor in possession shall—

"(1) within three days after the date of the order for relief under this chapter, file a statement, verified by the debtor in possession and by any counsel employed or proposed to be employed under section 327 of this title, that the debtor has been informed of the duties and responsibilities of a debtor in possession;

"(2) within 20 days after the date of the order for relief under this chapter, transmit to the United States trustee—

Page 171 PREV PAGE TOP OF DOC

"(A) a copy of the debtor's most recent Federal income tax return, which the United States Trustee shall make available, on request, to a party in interest for inspection only; and

"(B) any balance sheet, income statement and statement of cash flows for the debtor prepared on a monthly or, if not available, quarterly basis within one year before the date of the order for relief, which the United States Trustee shall make available, on request, to any party in interest, or if any such document does not exist, a verified statement that the document does not exist;

"(3) attend, through management and with counsel, any initial debtor interview, scheduling conference, confirmation hearing, meeting of creditors under section 341 of this title and any other meeting or hearing if so ordered by the court;

"(4) file all schedules and statements of financial affairs within the time required, without extension, under the Federal Rules of Bankruptcy Procedure, unless the court extends the time to not more than 30 days after the date of the order for relief under this chapter, or, if there is a reasonable justification, a later time;

"(5) timely file periodic reports that provide the following information—

"(A) the debtor's receipts and disbursements for the fiscal periods specified by the Federal Rules of Bankruptcy Procedure;

Page 172 PREV PAGE TOP OF DOC

"(B) whether the debtor is in material compliance with all postpetition requirements imposed by this title and the Federal Rules of Bankruptcy Procedure;

"(C) whether the debtor has timely filed all tax returns and paid all administrative claims when due, and, if not, what the failures are and how, at what cost, and when the debtor intends to remedy such failures; and

"(D) such other information as the court determines is needed in the best interest of the debtor and creditors and in the public interest in fair and efficient procedures under this chapter.

"(6) timely file all other reports required by the Federal Rules of Bankruptcy Procedure or by local rule;

"(7) to the extent commercially practicable, maintain insurance customary for the kind of business in which the estate is engaged after the date of the order for relief under this chapter;

"(8)(A) timely file all tax returns required for the estate;

"(B) timely pay all administrative expense tax claims, except claims being contested by appropriate proceedings being diligently prosecuted; and

"(C) establish a separate deposit account not later than ten business days after the date of the order for relief under this chapter (or as soon as possible after the ten-day period if during the ten-day period all banks contacted decline to open the necessary account) and deposit in the account, not later than five business days after receipt, all taxes collected or withheld for a governmental unit;

Page 173 PREV PAGE TOP OF DOC

"(9) timely pay all administrative wage claims; and

"(10) allow the United States trustee to inspect the business premises, books, and records of the debtor in possession at reasonable times, after reasonable prior written notice, unless the debtor in possession waives notice.".

(b) Conforming Amendment.—The table of sections of chapter 11 of title 11, United States Code, is amended by inserting after the item relating to section 1114 the following:

"1209. Duties of a debtor in possession in a chapter 12 case.".

Sec. 225. Conversion or Dismissal of Chapter 12 Cases.

(a) Section 1208(b) of title 11, United States Code, is amended by striking "or 1112" and inserting ", 1112, or 1307" in lieu thereof.

(b) Section 1208(c) of title 11, United States Code, is amended to read:

"(c) On request of a party in interest, or the United States trustee or bankruptcy administrator, and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interests of creditors of the estate, for cause including—

Page 174 PREV PAGE TOP OF DOC

"(1) unreasonable delay or gross mismanagement by the debtor that is prejudicial to creditors;

"(2) nonpayment of any fees and charges required under chapter 123 of title 28;

"(3) failure to file a plan within the time fixed under section 1221 of this title;

"(4) failure to commence making payments under section 1226 of this title within the time fixed by the plan or by the court;

"(5) denial of confirmation of a plan under section 1225 of this title and denial of a request made for additional time for filing another plan or a modification of a plan;

"(6) material default by the debtor with respect to a term of a confirmed plan;

"(7) revocation of the order of confirmation under section 1230 of this title, and denial of confirmation of a modified plan under section 1229 of this title;

"(8) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan;

Page 175 PREV PAGE TOP OF DOC

"(9) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;

"(10) fraud committed by the debtor in connection with the case;

"(11) material failure to comply with the reporting requirements of section 1209 of this title;

"(12) failure by the debtor to file, within 15 days after the date of the filing of the petition or such additional time as the court allows, the information required by section 521(1) of this title and a list containing names and addresses of the holders of the 20 largest unsecured claims (or of all unsecured claims if there are fewer than twenty unsecured claims), and the approximate dollar amounts of each such claim;

"(13) failure by a debtor to attend the meeting of creditors under section 341(a) of this tile or an examination ordered under Rule 3004 of the Federal Rules of Bankruptcy Procedure.

"(14) unauthorized use of cash collateral in disregard of the requirements of this title, causing material harm to one or more creditors; or

"(15) material failure of the debtor to comply with a material order of the court.".

(c) Section 1208 of title 11, United States Code, is amended by striking subsection (d) and redesignating subsection (e) as subsection (d).

Page 176 PREV PAGE TOP OF DOC

SUBTITLE III—EFFECTIVE DATE

Sec. 241. Effective Date

(a) Except as otherwise provided in this section, this Act and the amendments made by this Act shall take effect 30 days after the date of enactment, but only with respect to cases under title 11 of the United Stated Code commenced 30 days or more after the date of enactment.

(b)(1) The reporting requirements of sections 1115(b)(5), 1115(b)(6), 1209(b)(5), and 1209(b)(6) of title 11, United States Code, as added by this Act, shall take effect 60 days after the date on which rules and forms are prescribed under section 2075 of title 28, United States Code.

(2) Notwithstanding paragraph (1) of this subsection, the reporting requirements of sections 1115(b)(6) and 1209(b)(6) of title 11, United States Code, as added by this Act, shall take effect 60 days after the date on which, where permitted by section 1115(b)(6), local rules are prescribed by the court in which there is pending a case under title 11 of the United States Code that is governed by section 1115 or 1209, as the case may be, if the requirements have not already taken effect under paragraph (1) of this subsection.

(c) The requirement imposed under sections 1115(b)(1) and 1209(b)(1) of title 11, United States Code, as added by this Act, shall take effect on the date of enactment of this Act, but for cases under title 11 commenced before or within 25 days after the date of enactment, the required statement shall be filed within 30 days after the date of enactment.

Until rules and forms are prescribed under section 2075, title 28, United States Code for compliance with sections 1115(b)(1) and 1209(b)(1) of title 11, the court may by local rule prescribe the form of statement to be used.

Page 177 PREV PAGE TOP OF DOC

APPENDIX F: SECTION BY SECTION ANALYSIS OF THE BANKRUPTCY REFORM ACT OF 1999 (FORMERLY THE CONFERENCE REPORT ON H.R. 3150, 105TH CONGRESS)

TITLE I.

Sec. 101. Conversion.

This section amends 11 U.S.C. §706(c) to permit a court to convert a chapter 7 case to one under chapter 13 with the debtor's consent.

COMMENTS: Under current law, the debtor must request conversion. This amendment, by itself, is not likely to produce a significant change.

Sec. 102. Dismissal or conversion.

Under this provision, *courts are required to presume that a case is abusive at ANY INCOME LEVEL* if the debtor's income is sufficient to pay the lesser of 25% of debts or $5,000 over five years. *See* section 102, proposed 11 U.S.C. §707(b)(2)(A)(i). Available monthly income is determined by deducting expenses according to the Internal Revenue Service's National Standards, Local Standards and Other Necessary Expenses allowance (excluding payments for debts), total payments for secured claims divided by 60 months, and total payments for priority claims divided by 60 months. Courts also may consider whether a case has been filed in bad faith and the totality of circumstances. A totality of the circumstances analysis includes consideration of whether the debtor filed the case primarily to reject a personal services contract.

Page 178 PREV PAGE TOP OF DOC

Likewise, the bill requires that trustees review all individual chapter 7 cases for ability to pay under the means test and submit a statement on their findings in each case to the court, regardless of the debtor's income level. *Id.*, proposed §704(10). Case trustees also must file and litigate a section 707(b) motion if the debtor's petition, schedules, and statements show the debtor's income is sufficient to pay at least 25% of general unsecured debts or $5,000 over five years and the debtor has income not less than the highest national median family income for a family of equal or lesser size.(see footnote 12)

To rebut the presumption of abuse, a debtor must prove "extraordinary circumstances that require additional expenses or adjustment of current monthly total income." The debtor and the debtor's attorney must swear to the extraordinary circumstances statement, which includes detailed itemizations and explanations. To be successful in this rebuttal, a debtor must show that extraordinary expenses reduce the debtor's monthly income under the proposed formula to an extent that renders the debtor unable to pay $5,000 or 25% as otherwise required.

This provision permits creditors to bring section 707(b) motions against debtors with incomes greater than the national median household income for a household of equal size.(see footnote 13) The court may award a debtor reasonable costs if a creditor's section 707(b) motion was not substantially justified or the creditor brought the motion solely for the purpose of coercing the debtor to waive a right provided or guaranteed by the Bankruptcy Code, unless the creditor's claim was less than $1,000. If a trustee prevails on a section 707(b) motion, section 102 requires that the debtor's *lawyer* reimburse the trustee for costs and attorneys' fees if the lawyer's action was not substantially justified. Section 102 also codifies some of the language of Rule 9011 of the Federal Rules of Civil Procedure for mandatory application to debtors' attorneys. If a debtors' attorney is found to have violated Rule 9011, the attorney will be subject to civil penalties, payable to the panel trustee or the U.S. trustee.

Page 179 PREV PAGE TOP OF DOC

COMMENTS: As drafted, this means test applies to all debtors, not just debtors above a certain income level. Although the means test has been added to section 707(b), which is generally perceived to be a provision that relies in part on court discretion, the amendment deprives courts of sufficient discretion to distinguish debtors who can make meaningful repayments in chapter 13 from those who cannot. As a result, some debtors with the ability to repay will get chapter 7 relief and some debtors without the ability to repay will be channeled into short-lived chapter 13 plans. It would be far preferable to require that courts dismiss or convert cases for clear abuse, based on the totality of the circumstances, which should include consideration of whether a debtor can pay all nonpriority unsecured debts in three years.

This provision creates the perception that creditors actually will be paid 25% of their nonpriority unsecured claims over five years in a chapter 13 plan. In fact, a case converted for ability to pay 25% of unsecured claims may not produce a 25% yield for unsecured creditors in an actual chapter 13 plan, even if the debtor successfully completes a five year plan. For example, substantial interest on secured or priority claims may accrue by deferring repayment of these claims over five years, as contemplated by the means test. Payment of interest on these claims will reduce income available to pay general unsecured claims. Thus, either section 102 should be amended to clarify that nothing in section 707(b) is intended to impose a percentage of debt requirement in the chapter 13 case of a debtor whose case was converted from chapter 7 based on the ability to pay or, alternatively, should overhaul the means test so that it more accurately identifies debtors who actually could pay 25% (in nominal value) of nonpriority unsecured claims in a chapter 13 plan. Moreover, by subtracting from income only contractual payments due on secured debts, this means test fails to take into account payments necessary to cure defaults, leading to further overestimation of the debtor's ability to pay nonpriority unsecured debts.

Page 180 PREV PAGE TOP OF DOC

In addition, the timetable in proposed 11 U.S.C. §704(10) is not feasible. If a panel trustee files the requisite statement with the court only 10 days before the date of the first meeting of creditors, the court may be unable to even send copies of the statement within 5 days, much less ''provide'' all creditors with copies as the provision requires. Even if the court sends the copies within 5 days, the copies might not reach creditors soon enough to allow creditors to read them in preparation for the first meeting of creditors. A trustee should not have to submit his statement to the court until after the first meeting of creditors.

The paragraphs following proposed section 704(10) (numbered (3)(A), (B) and (C), 4(A) and (B), and (5)) are misplaced and are intended to be amendments to section 707(b) and should precede the amendment to section 704 adding paragraph (10).

The reference to a ''panel trustee APPOINTED UNDER SECTION 586(a)(1) OF TITLE 28'' in the first two lines of paragraph 3(A) is unnecessary; 28 U.S.C. §586(a)(1) refers to the appointment of an individual as a member of the panel of private trustees, not to the individual's appointment to serve as trustee in a specific chapter 7 case. The underlined language may be deleted altogether or substituted with ''appointed under section 701, 702 or 703 of this title''. In addition, the two references to ''However,'' in paragraph (5) should be deleted.

If section 707(b) is going to be available for creditors to challenge the cases of higher income chapter 7 debtors, the threshold for allowing creditor motions should be family income or the income of one earner in the instance of a debtor living alone, not household income. See median income data in footnotes 1 and 2. Thus, paragraph (5) should be amended by striking ''national median household income calculated on a monthly basis for a household of equal size'' and inserting ''national median family income calculated on a monthly basis for a household of equal size or, in the case of a household of one person, the national median family income for one earner calculated on a monthly basis''.

Page 181 PREV PAGE TOP OF DOC

All attorneys representing parties in bankruptcy cases are already subject to Rule 9011 of the Federal Rules of Bankruptcy Procedure. Like Rule 11 of the Federal Rules of Civil Procedure, Rule 9011 penalizes all attorneys for sanctionable behavior. The bankruptcy system should continue to rely on Rule 9011 as the basis for civil sanctions on lawyers. Although fee shifting against debtor's lawyers and the codification of Rule 9011 applicable only to debtors' lawyers may discourage some chapter 7 filings and thus has superficial appeal, surely there are alternative methods of attaining this goal that do not compromise the ethical obligations of bankruptcy lawyers under state codes of conduct.

Sec. 103. Notice of alternatives.

This section amends 11 U.S.C. §342(b) so that an individual seeking bankruptcy relief must obtain a written notice prescribed by the United States trustee before the commencement of a case. This written notice must contain a brief description of bankruptcy options (*e.g.*, chapter 7 versus chapter 13) and credit counseling services approved by the United States trustee. The notice may be given as part of the prebankruptcy credit counseling certification requirement described in section 302 of this bill.

COMMENTS: Increasing consumers' awareness of alternatives to bankruptcy is a good idea in theory, but pro se filers may not know to comply with the requirements imposed by this provision and section 302 of this bill. In some districts such as the Central District of California, a significant portion of consumer debtors are pro se filers. As a technical matter, the reference to section 586 of title 28 in the second to last line of subsection (b), is unnecessary and should be deleted.

Page 182 PREV PAGE TOP OF DOC

Sec. 104. Debtor financial management training test program.

This section instructs the Executive Office for United States Trustees to consult with a wide range of individuals with expertise in the field of debtor education and to develop a financial management training curriculum and materials. In addition, the Executive Office must establish pilot programs in three judicial districts for a one year period beginning not later than 270 days after enactment of this Act, during which the curriculum and materials are available to individual debtors. During this one year period, the Director of the Executive Office for United States Trustees must evaluate the effectiveness of the curriculum and materials, other preexisting consumer education programs. Not later than three months after concluding the evaluation, the Director must submit a report to Congress.

COMMENTS: The timing of the pilot program should be adjusted to provide an ample opportunity to prepare the curriculum and materials and to evaluate the pilot programs. Before determining whether a financial management training program is effective, it may take several years to assess whether the program prevents people from repeating the mistakes that led them into financial trouble and bankruptcy. In addition, because appropriations will be necessary to implement this provision, section 104 should not become effective until the later of October 1, 2000 or one year after the date of enactment of this bill.

Sec. 105. Definitions.

This section introduces new terms into the bankruptcy lexicon such as "bankruptcy assistance," "assisted person," and "debt relief agency" for application to subsequent sections of this bill that prescribe the activities of lawyers and bankruptcy petition preparers.

Page 183 PREV PAGE TOP OF DOC

COMMENTS: These definitions encompass a wide range of parties, such as bookstores, which may extend the application of the subsequent sections beyond their intended scope.

As a technical matter, the reference in section 105(a)(1) to ''paragraph (3)'' of 11 U.S.C. §101 should be eliminated. Section 101 does not have a paragraph (3). The new definition of ''assisted person'' therefore can be numbered as *paragraph (3). In addition, this provision designates the definition of ''debt relief agency'' as section 101(12B), but paragraph (12A) is eliminated by section 141 of this bill, and therefore the ''debt relief agency'' definition may be inserted as section 101(12A).*

Sec. 106. Disclosures.

This provision requires that parties offering bankruptcy assistance provide certain notices and disclosures to debtors, including statements delineating the responsibilities undertaken by debt relief agencies in the bankruptcy process. The disclosures must notify the debtor that anyone providing bankruptcy assistance must provide information regarding the valuation of assets at replacement value, the determination of monthly income, and the determination of exempt property.

COMMENTS: This provision is objectionable to the extent that it instructs nonattorney petition preparers to give legal advice. As a technical matter, paragraph (d) of proposed section 526. requires that notice be maintained for ''two years after the later of the date on which the notice is given'' (emphasis added) but does not contain an alternative event to trigger the running of the two year period.

Page 184 PREV PAGE TOP OF DOC

Sec. 107. Debtor's bill of rights.

This section imposes additional requirements on parties providing bankruptcy assistance and prohibits a debt relief agency from making a untrue or misleading statement that the agency should have known was untrue or misleading.

COMMENTS: It is appropriate to discourage the issuance of false and misleading statements by those counseling financially troubled consumers. However, calling this provision ''Debtor's bill of rights'' may overstate the value of this provision. This bill on the whole is deficient in protecting debtors against fraudulent coercive practices.

Sec. 108. Enforcement.

Under this section, a debt relief agency that fails to comply with the aforementioned requirements must disgorge fees or waive unpaid fees. This section also authorizes civil penalties and injunctive relief.

COMMENTS: By voiding the contract for services, this provision may deprive a debtor of the right to enforce the obligations of a petition preparer.

Sec. 109. Sense of the congress.

This provision states that "[i]t is the sense of the Congress that States should develop curricula relating to the subject of personal finance, designed for use in elementary and secondary schools."

Page 185 PREV PAGE TOP OF DOC

COMMENTS: This provision is unobjectionable.

Sec. 110. Discouraging abuse[sic.] reaffirmation practices.

This provision amends 11 U.S.C. §524 to provide that a debtor is entitled to a hearing regarding a reaffirmation of an unsecured debt, during which the court would decide whether "the agreement is an undue hardship, not in the debtor's best interest, and not the result of a threat by the creditor to take any action that cannot be legally taken or that is not intended to be taken." However, this requirement is waivable by debtors represented by counsel. This provision does not authorize hearings for reaffirmation of unsecured debts owed to credit unions or nominally secured debts.

COMMENTS: This provision is insufficient. It does not substantially change current law, which has proven to be inadequate. The importance of reviewing reaffirmations is heightened if creditors are permitted to bring section 707(b) motions, the threat of which may be used as leverage to extract reaffirmation agreements. Reaffirmation review should be mandatory at least for all unsecured and nominally secured debts. Section 211 of H.R. 3150 that passed the Senate 97 to 1 last year is far preferable to this provision. A modified reaffirmation procedure should be accompanied by explicit injunctive protection to enjoin threats against debtors of nondischargeability actions and section 707(b) motions, as provided in section 210 of H.R. 3150 as passed by the Senate.

The grammatical problem in the heading of this section should be fixed by striking ''abuse'' and inserting ''abusive''.

Page 186 PREV PAGE TOP OF DOC

Sec. 111. Promotion [of] alternative dispute resolution.

This provision authorizes a court to reduce an unsecured consumer debt claim by up to 20% if the debtor proves by clear and convincing evidence that the creditor holding the claim refused to negotiate a reasonable alternative repayment schedule offered by the debtor at least 60 days before the filing of the petition if that repayment schedule would have resulted in the repayment of at least 60% of the debt over a reasonable period. The court's authority to reduce claims on this basis does not apply to nondischargeable debts. This provision also protects payments from avoidance as preferential transfers if the payments were part of an alternative repayment plan created by an approved credit counseling agency.

COMMENTS: This provision first appeared in the Conference Report on H.R. 3150 and may produce considerable litigation. Further study is necessary to determine whether this provision is necessary or desirable. If this provision is retained, the heading should be changed because alternative dispute resolution generally refers to arbitration, mediation, or similar activities, which is not the intended activity. If the section heading is not otherwise changed, the word ''of'' should be inserted between the words ''promotion'' and ''alternative''. In addition, the appropriate burden of proof for bankruptcy proceedings and contested matters is by a preponderance of the evidence, not clear and convincing evidence. Grogan v. Garner, 498 U.S. 279, 111 S. Ct. 654 (1991).

Sec. 112. Enhanced disclosure for credit extensions secured by a dwelling.

This provision authorizes the Federal Reserve to study whether consumers who obtain high loan to value mortgages receive adequate information about the income tax deductibility of interest on the unsecured portion of such loans, and whether additional disclosures are necessary.

Page 187 PREV PAGE TOP OF DOC

COMMENTS: This provision should be rejected in favor of section 207 of H.R. 3150 as passed by the Senate by a vote of 97 to 1. The Senate version reasonably requires that solicitations and applications notify potential borrowers that tax benefits of home equity lending are limited to the portion that is secured by the value of the collateral. Enhanced disclosure is critical to educating consumers and decreasing the likelihood of insolvency and bankruptcy.

Sec. 113. Dual use debit card.

This provision authorizes a study of existing protections that limit consumers' liability for unauthorized electronic fund transfers. Not later than 2 years after enactment of this bill, the Federal Reserve must issue a report on its findings and issue regulations accordingly.

COMMENTS: This amendment is far less proactive than section 208 of H.R. 3150 as passed by the Senate, which amends the Electronic Fund Transfer Act to delineate the circumstances in which consumers are liable for unauthorized electronic fund transfers.

Sec. 114. Enhanced disclosures under an open-end credit plan.

Section 114 amends the Truth in Lending Act to require that credit card monthly statements contain certain additional boilerplate disclosures about the minimum monthly payment. The amendment requires that creditors provide a worksheet to help the borrower to determine his household income and debt obligations. This section authorizes the Federal Reserve to study whether consumers receive adequate information about borrowing, particularly in open end credit plans such as credit cards, to submit a report to Congress within two years after the date of enactment, and to require additional disclosures if necessary.

Page 188 PREV PAGE TOP OF DOC

COMMENTS: The proposed boilerplate language will mislead the majority of consumers with revolving debt who have larger balances, longer amortization periods and higher finance charges than the boilerplate language describes. This problem is exacerbated if the disclosures are based on a teaser rate of interest rather than the interest rate that actually will be applied to the consumer's charges. This amendment should be replaced with a provision along the lines of section 209 of H.R. 3150 as passed by the Senate. Section 209 requires that credit card lenders state the required minimum monthly payment on the borrower's balance in dollar amount and as a percentage of the balance and the number of months necessary to pay the entire balance and the total cost to the consumer of paying the balance in full if the consumer makes only the minimum monthly payments and incurs no additional debt. Senator Durbin's provision also entitles credit card applicants to copies of their credit reports. These steps are integral to increasing consumer financial understanding, and correspondingly, decreasing the number of consumer bankruptcies.

Sec. 115. Protection of savings earmarked for the postsecondary education of children.

This provision is intended to provide an exemption for qualified tuition funds and education individual retirement accounts to the extent that the debtor transferred funds to these accounts to educate dependents, not to defraud creditors. As drafted, section 115 amends 11 U.S.C. §522 to exempt contributions to qualified funds made at least 365 days before bankruptcy that are not subject to a security interest, but such funds are not exempt unless the debtor has one or more dependent children under 22 years of age, "if the amounts do not exceed the lesser of $50,000" per child or $100,000 to all children, "to the extent such funds contributed to such account exceed $500 per year per child," and if any individual other than the dependent child has ownership rights to such funds or can direct the application of such funds for a purpose other than education.

Page 189 PREV PAGE TOP OF DOC

COMMENTS: As drafted, this provision is incomprehensible, changes the intended exemption, and does not protect against abuse. The provision needs to be re-drafted.

If the current form of this provision is retained, it can be improved if subparagraph (5)(B) is revised to read as follows: ''(B) To the extent that the amounts in such accounts and programs exceed $50,000 (in the aggregate) in accounts and programs attributable to any such dependent child or exceed $100,000 (in the aggregate) in accounts and programs attributable to all such dependent children;'' In addition, proposed subparagraphs (D)(i) and (D)(ii) of section 522(b)(2) include a requirement that the funds have not been pledged or promised to any person in connection with any extension of credit. This provision is unnecessary with respect to tuition programs because section 529(b)(7) of the Internal Revenue Code expressly provides that a program may not permit any interest therein to be used as a security for a loan. Even if a creditor had a security interest in educational funds, a lender holding a security interest in an otherwise exempt asset may enforce the security interest in most states regardless of the exemption unless the security interest is avoided under another provision of state law or of the Bankruptcy Code. Whether or not the reference to a pledge is eliminated, the provision should state explicitly that the exemption will be lost only to the extent of the pledge. For example, if the account contains $50,000 and is subject to a security interest securing a debt of only $20,000, the remaining $30,000 should be exempt.

The $500 per year per child limit contained in subparagraph (5)(C) keys into Internal Revenue Code section

530(b)(1)(A)(iii). However, the Internal Revenue Code states that the $500 per year limit is subject to an exception in the case of rollover accounts. See 26 U.S.C. §530(d)(5). This exception for rollover accounts should be incorporated into subparagraph (5)(C).

Page 190 PREV PAGE TOP OF DOC

The internal reference to section 330 in subsection (a) (bottom of page 18) is erroneous and should be deleted. Subparagraph (5)(B) includes an unnecessary reference to ''postsecondary'' accounts that should be deleted.

Sec. 116. Effect of discharge.

Under section 116, a creditor's willful failure to properly credit repayment plan distributions violates the injunction automatically imposed by 11 U.S.C. §524 when a debtor receives a discharge. If an individual debtor is injured by the failure of a creditor to comply with the reaffirmation agreement requirements in sections 524(c) and (d) or a creditor's willful violation of section 524(a)(2), the debtor may be entitled to recover costs, attorneys' fees, and damages. However, departing from both the House and Senate bills, this provision also states that "an action to recover for a violation specified in paragraph (1) [violation of the reaffirmation procedures] may not be brought as a class action."

COMMENTS: This provision appropriately imposes sanctions in the event that a party willfully violates the discharge injunction and reaffirmation procedures, which has been a persistent problem under current law. See, e.g., Night of the Living Debt; Discharged Bills Come Back—Often Illegally—to Haunt Bankruptcy Filers, The Washington Post p. H01 (September 13, 1998) (citing postbankruptcy collection practices of certain retailers that have admitted to such conduct).

Regardless of one's general views on class action lawsuits, it is inappropriate to restrict class actions in the manner proposed in this section. In some instances, class actions have been the primary compensatory remedy for low income consumers who have been the victims of abusive and coercive practices.

Page 191 PREV PAGE TOP OF DOC

Sec. 117. Automatic stay.

This section amends 11 U.S.C. §362(h) to retract from current law by eliminating the authorization of punitive damages in appropriate circumstances for violations of the automatic stay. The provision also states that an action to recover from a violation of the automatic stay may not be brought as a class action.

COMMENTS: This section should be deleted in its entirety. The automatic stay is essential to protect the assets of a bankruptcy estate for the benefit of all creditors. No justification has been provided for relaxing the penalties for actions in flagrant and intentional violation of the automatic stay. In addition, it is inappropriate to restrict class actions in the manner proposed. A preferable provision would amend section 362(h) so that it applies to all debtors, not just individual debtors. To accomplish this result, the reference to ''individual'' should be deleted and replaced with ''entity.''

Sec. 118. Reinforce the fresh start.

This section amends 11 U.S.C. §523(a)(17) to clarify that this exception to discharge for court costs applies only to prisoners.

COMMENTS: The National Bankruptcy Conference supports this amendment.

Sec. 119. Discouraging bad faith repeat filings.

Page 192 PREV PAGE TOP OF DOC

Under this provision, the automatic stay terminates 30 days after the filing of a petition for relief under title 11 by an individual if the individual was a debtor in another case that was dismissed within the previous year. A party in interest may seek an extension of the stay by showing that the later case is in good faith. A case presumptively is not in good faith if the debtor filed more than one previous case within the year, if a prior case was dismissed after the debtor did not file the requisite documents without substantial excuse, if the debtor did not provide adequate protection in accordance with section 137 of this bill, if the debtor did not perform the terms of a confirmed plan, or if the debtor's financial condition and personal affairs have not changed substantially since the last case was dismissed. In addition, a case presumptively is not in good faith as to a particular creditor if the creditor sought relief from the automatic stay in the prior case and that action was pending upon dismissal or had been resolved in the creditor's favor. A presumption that a case is not in good faith is rebuttable by clear and convincing evidence. The automatic stay does not apply at all to the case of an individual who has been a debtor in two or more dismissed cases within the previous year, although a party in interest may request that a stay be imposed by showing that the case is in good faith (with presumptions similar to those listed above).

COMMENTS: The National Bankruptcy Conference supports restrictions to deter abusive repeat filings, subject to some minor technical revisions. The standard for rebutting a presumption should be by a preponderance of the evidence, not clear and convincing evidence.

Sec. 120. Curbing abusive filings.

Page 193 PREV PAGE TOP OF DOC

This section establishes standards for the application of *in rem* orders that make the automatic stay inapplicable to an identified property interest in future cases. This order may be issued upon a court finding that the filing of a bankruptcy petition was part of a scheme to hinder, delay, and defraud creditors involving the transfer of an interest in real property or multiple bankruptcy filings affecting that property. An *in rem* order remains in effect for two years, although parties may obtain relief from an *in rem* order for good cause or changed circumstances. In addition, this provision makes the automatic stay inapplicable to any act to enforce a lien against property of a debtor who is ineligible for bankruptcy relief pursuant to 11 U.S.C. §109(g) or a prior court order. This provision is the same as section 731 of H.R. 3150 as passed by the Senate.

COMMENTS: The National Bankruptcy Conference supports this provision. The reference in section 362(d)(4) should be changed so that the two-year period in that provision runs from the date of the entry of the order, not the recording. This can be accomplished by striking ''not later than 2 years after that recording'' and inserting ''not later than 2 years after the entry of the order''.

Sec. 121. Debtor retention of personal property security.

This section prohibits the "ridethrough" of secured debt obligations in chapter 7. If a debtor does not redeem or reaffirm a debt secured by personal property within 45 days after the first meeting of creditors, the creditor's collateral "no longer shall be property of the estate," and the creditor may take any action against the property permitted under applicable nonbankruptcy law unless the court determines on the motion of a trustee that the property is of consequential value to the bankruptcy estate. The provision does not provide time limits for the motion of the trustee. Section 121 also clarifies that redemption requires payment in a single lump sum, consistent with the majority view of redemption.

Page 194 PREV PAGE TOP OF DOC

COMMENTS: By prohibiting ridethrough, this provision forecloses an option that works well for both debtors and creditors in the jurisdictions in which it currently is permitted. Policy decisions aside, this provision may create more problems than it solves by calling for automatic removal of the collateral, potentially before it is determined that the property is of value to the estate. What if the collateral already has been sold? The provision should require that a *motion be filed before the estate excludes the property. In addition, although the collateral may no longer be property of the estate, it still may be property of the debtor and therefore subject to automatic stay protection. Similarly, if the debtor is contesting the validity of, or is seeking to avoid, the security interest (similar to the proposed section 521(c) in section 122 of this bill that creates an exception for voidable security interests), or if the debtor attacks a security interest as being invalid under state law, the property should not be abandoned to the creditor.*

With respect to redemption, it is appropriate to clarify that a debtor must provide a lump sum payment to the party holding a security interest in that property.

Sec. 122. Relief from the automatic stay when the debtor does not complete intended surrender of consumer debt collateral.

Section 122 authorizes automatic stay relief without court permission if a debtor fails to file a statement of intention or to follow through on the statement of intention (unless the statement specifies reaffirmation and the creditor refuses to reaffirm on the original contract terms), except if the court determines on the motion of a trustee that the property is of consequential value or benefit to the estate.

Page 195 PREV PAGE TOP OF DOC

COMMENTS: This provision has some of the same logistical problems as section 121 and provides an incomplete solution. Even if the collateral is deemed not to be property of the estate, it may be considered property of the debtor that remains subject to the automatic stay. This provision should be revised to provide that a debtor's failure to file a statement of intention or to follow through on a statement of intention triggers abandonment of the property to the debtor. The creditor may exercise its rights except to the extent that it seeks to enforce ipso facto clauses triggered by the bankruptcy or insolvency of the debtor.

Sec. 123. Giving secured creditors fair treatment in chapter 13.

According to this section, the holder of an allowed secured claim retains its lien until the debtor pays the entire debt (including the unsecured portion) or until receipt of a chapter 13 discharge.

COMMENTS: Current law is divided on whether a lien is released when the allowed secured claim has been paid off or when the repayment plan has been completed. See In re Johnson, 213 B.R. 552 (Bankr. N.D. Ill. 1997) (collecting cases split on question of lien retention). This provision may encourage some debtors to remain committed to their repayment plans but may also result in a higher rate of repossessions of collateral.

Sec. 124. Restraining abusive purchases on secured credit.

This provision amends 11 U.S.C. §506 so that debts partially secured by personal property purchased by an individual debtor within 5 years before the filing of a bankruptcy petition are not bifurcated into secured and unsecured claims. If the allowed claim is secured only by the personal property so acquired, the value of the personal property and the amount of the allowed secured claim "shall be the sum of the unpaid principal balance of the purchase price and accrued and unpaid interest and charges at the contract rate." If the claim is secured by other property as well, the value of the security shall be "not less than the unpaid principal balance of the purchase price of the personal property and unpaid interest and charges at the contract rate." If the individual is a debtor in a subsequent case within two years after the date the original petition was filed, the value of the allowed secured claim will be calculated in the same manner in the subsequent case.

Page 196 PREV PAGE TOP OF DOC

COMMENTS: The National Bankruptcy Conference opposes this provision and recommends its deletion. This provision not only eliminates the stripdown of partially secured debt, but it values property at more than its original purchase price by including accrued interest and penalty charges. Contrary to the stated intention of this legislation, *this provision creates an incentive for debtors to file under chapter 7, as opposed to chapter 13, or to surrender collateral to the lender, and diverts value from unsecured creditors in favor of undersecured creditors. The Bankruptcy Code should give creditors what they otherwise would receive under state law; treating a creditor as fully secured when that creditor's interest is substantially undersecured deviates from this fundamental principle.*

If this provision is adopted notwithstanding these concerns, the five year period should be reduced to 90 days and exclude retail charge card debts. Beyond 90 days, a presumption of abuse is no longer sustainable.

Sec. 125. Fair valuation of collateral.

Under section 125, the allowed secured claim for a debt secured by personal property is determined by the collateral's replacement value, defined as the price a retail merchant would charge for property of that kind, age, and condition, with no deductions for marketing or sales costs.

COMMENTS: Although this provision uses the term replacement value, it overrules the holding of Associates Commercial Corp. v. Rash, ***XX*** **U.S. XX, 117 S. Ct. 1879 (1997), by requiring that debtors—and consequently, unsecured creditors—pay for attributes that the debtor did not receive. Like section 125, this provision is inconsistent with the goal of maximizing returns to unsecured creditors. Most property acquired for personal family or household purposes do not have an easily determined replacement value as defined in this provision because retail merchants dealing in new goods rarely sell used goods as well. Second hand stores carry a restricted range of items that may not be comparable to the item of property to be valued. If Congress chooses to legislate in this area, the fair valuation of collateral in bankruptcy should be the value of the property in the hands of a creditor following foreclosure, which properly reflects what the creditor realistically would receive under state law. The costs of marketing or sales costs should be deducted, as the Supreme Court held in Rash.**

Page 197 PREV PAGE TOP OF DOC

Sec. 126. Exemptions.

Under section 126, to be subject to the exemption laws of a state, a debtor must be domiciled in a state for the 730 days immediately preceding the date of the filing of the petition, not just the greater portion of that period.

COMMENTS: This provision may produce unintended consequences by leaving ambiguous the rights of debtors who have not lived in a state for 730 days prior to filing for bankruptcy. Although the provision may leave open the possibility of using the federal exemptions, it is possible that the debtor will receive no exemptions at all, requiring debtors to give up all property, including their home, clothing, pots and pans, children's toys, and family heirlooms. This provision should be rejected in favor of a cap on unlimited homestead exemptions, but in the event it is retained, the amendment should at the end of section 522(b)(2)(A) the following: ", but if the debtor's domicile has not been located in one place for the 730 days preceding the date of the filing of the petition, the debtor may exempt from property of the estate the property listed in subsection (d) of this section."

Sec. 127. Limitation.

This section provides that the exemption of a debtor's equity in a homestead shall be reduced to the extent such value is attributable to any portion of property that the debtor "disposed of" within 730 days before the bankruptcy petition date with the intent to hinder, delay or defraud a creditor.

Page 198 PREV PAGE TOP OF DOC

COMMENTS: This provision does not make a meaningful addition to the current bankruptcy laws. Current law already authorizes the avoidance of transfers, or the denial of a discharge altogether, when debtors transfer property with the actual intent to hinder, delay, or defraud within one year before the date of the filing of the petition. 11 U.S.C. §548(a)(1), 727(a)(2). Trustees also may recover constructive fraudulent transfers within one year before filing for *bankruptcy. Id. §548(a)(2). In addition, using applicable state law, trustees may recover actual or constructive fraudulent conveyances transfers made within 2, 4, or in some states even 6 years before the bankruptcy filing. Id. §544(b). This provision fails to close the loophole in current bankruptcy law: fraudulent transfer laws do not protect creditors in the cases of individuals who amass considerable wealth in exempt property but do not make any transfers. To prevent debtors from discharging their debts while retaining property of high value, a cap should be imposed on all homestead exemptions.*

Sec. 128. Rolling stock equipment.

This section amends 11 U.S.C. §1168 and 1110 to provide even greater protections to creditors secured by rolling stock equipment and aircraft and lessors of the same. These amendments require that a trustee or debtor-in-possession perform all obligations and cure all defaults in accordance with the terms of such security agreement, lease, or conditional sale contract, and required that a trustee surrender property if the vendor or lessor makes a written demand and otherwise would be entitled to take possession.

COMMENTS: The amendment to section 1110 legislatively overrules Western Pacific Airlines, Inc. v. Gatx Capital, 221 B.R. 1 (D. Colo. 1998). These amendments expand, but do not dramatically change, the protection for aircraft and rolling stock lessors and secured creditors that the Bankruptcy Code already provides. The National Bankruptcy Conference generally opposes special interest provisions that provide preferential treatment for a particular type of creditor to the detriment of other creditors without an adequate policy justification for the distinction.

Page 199 PREV PAGE TOP OF DOC

Sec. 129. Discharge under chapter 13.

This section amends 11 U.S.C. §1328 so that a debtor who completes a 3 to 5 year chapter 13 plan may not discharge debts that are nondischargeable under 11 U.S.C. §523(a)(2), (3)(B), (a)(4), and (a)(6) (if resulting from a willful and malicious injury by the debtor that caused personal injury or death).

COMMENTS: The National Bankruptcy Conference supports this provision only to the extent that it excludes from the superdischarge debts falling under section 523(a)(6) that result from a willful and malicious injury by the debtor that caused personal injury or death. Under current law, approximately one third of confirmed chapter 13 repayment plans are completed and consequently result in a discharge of most remaining debts, including debts that may have been nondischargeable in a chapter 7 case. Because the current superdischarge obviates the need for most nondischargeability litigation, the extent of the effect restricting the superdischarge is unknown. If the scope of the discharge in chapter 7 and chapter 13 are relatively coextensive, the incentive to file chapter 13 is reduced. Debts falling under section 523(a)(2)(A) may include ordinary credit card debts, which should not be excepted from discharge in chapter 13.

Increased nondischargeability in chapter 13 intensifies the need to address another issue: separate classification of nondischargeable claims for purposes of a repayment plan. Courts are divided on whether chapter 13 debtors may separately classify nondischargeable debts and commit a higher amount of disposable income to those debts. Cf. Groves v. LaBarge, 39 F.3d 212 (8th Cir. 1994) (nondischargeability, by itself, is insufficient to warrant separate classification under section 1322(b)(1)) with In re Tucker, 159 B.R. 325 (Bankr. D. Mont. 1993) (permitting separate classification of nondischargeable debts). If a chapter 13 debtor may not commit concentrated portions of income to debts that survive the discharge, a debtor who completes a repayment plan may be faced not only with the residual debt, but with substantial accrued interest as well. Thus, a restriction on nondischargeability should be accompanied with a provision permitting separate classification of nondischargeable debts or a provision imposing a moratorium on interest accrual for the duration of a repayment plan. Draft language will be provided on request.

Page 200 PREV PAGE TOP OF DOC

Sec. 130. Bankruptcy judgeships.

This provision authorizes temporary judgeships and requires disclosure of judges' travel expenses.

COMMENTS: This provision differs from the judgeship bill that previously passed the House, H.R. 1596, by authorizing judgeships on only a temporary basis and by requiring travel related disclosures.

Sec. 131. Additional amendments to title 11, United States Code.

Section 131 amends 11 U.S.C. §523(a)(9) to explicitly except from discharge debts resulting from drunk boating and amends 11 U.S.C. §507(a) to give priority status to allowed claims for death and personal injuries resulting from drunk boating or drunk driving

COMMENTS: The National Bankruptcy Conference opposes this provision. Due to the fact that all priority debts must be repaid in full in the course of a chapter 13 plan, granting priority status to this type of debt decreases the likelihood that chapter 13 debtors with a debt of this kind will successfully repay debts in chapter 13 plans. The amendment to section 523(a)(9) duplicates the amendment made in section 1113 of this bill.

Sec. 132. Amendment to section 1325 of title 11, United States Code.

Page 201 PREV PAGE TOP OF DOC

Section 132 amends 11 U.S.C. §1325(b)(2) (the "disposable income" requirement) so that one must deduct off the top reasonable child support payments, foster care payments, or disability payments for a dependent child when calculating disposable income available for payment of nonpriority unsecured claims in a chapter 13 plan.

COMMENTS: This amendment is consistent with the intent of 11 U.S.C. §1325(b).

Sec. 133. Application of the codebtor stay only when the stay protects the debtor.

Section 133 provides that the stay protecting codebtors in chapter 13 cases terminates 30 days after the date of the order for relief if a debtor did not receive the consideration for the claim "to the extent that the creditor proceeds against the individual that received that consideration or property not in possession of the debtor that secures that claim." The codebtor stay also is lifted postconfirmation when a debtor's plan provides for surrender or abandonment of the debtor's interest in personal property subject to a lease. These new rules are inapplicable when the debtor is primarily obligated to pay the creditor under a legally binding divorce decree or separation agreement.

COMMENTS: The chapter 13 codebtor stay generally protects codebtors while a debtor attempts to pay the joint obligation in a chapter 13 plan. The policy justification for this change is unclear.

Sec. 134. Adequate protection for investors.

Page 202 PREV PAGE TOP OF DOC

This section adds another exception to the automatic stay permitting a securities self regulatory organization to commence or continue an investigation or action, other than for monetary sanctions, without first seeking court approval.

COMMENTS: The National Bankruptcy Conference generally opposes provisions that prefer a particular type of creditor over other creditors without a sufficient policy justification for the distinction. The expansion of exceptions to the automatic stay for actions by governmental units through this provision, section 144 of this bill, and section 603 of the Omnibus Consolidated and Emergency Appropriations Act, 1999, Pub. L. No. 105–277 (striking 11 U.S.C. §362(b)(4) and (b)(5) and replacing them with a new provision), heightens the importance of imposing explicit limitations to narrowly define the police and regulatory power statutorily to exclude actions taken for purely pecuniary *purposes, making the following amendment necessary:*

Section 362 of title 11, United States Code, is amended by adding at the end the following—

(i) In this section, ''police and regulatory power'' excludes any act, action, or proceeding that affects property of or from the estate to secure or satisfy, in whole or in part, a debt.

Sec. 135. Limitation on luxury goods.

Section 135 amends 11 U.S.C. §523(a)(2)(C) to presumptively except from discharge any debts of $250 or more owed to a single creditor for cash advances or luxury goods or services within 90 days before the bankruptcy filing. This provision expands current section 523(a)(2)(C) in two ways. It extends the presumptive time period from 60 to 90 days and it permits a wider range of debts to be presumed nondischargeable by lowering the threshold from $1,000 to $250.

Page 203 PREV PAGE TOP OF DOC

COMMENTS: The National Bankruptcy Conference generally opposes provisions that prefer one type of creditor over others without a policy basis for the distinction. This provision is preferable to prior versions of this amendment but still is an objectionable expansion of nondischargeability for the benefit of credit card lenders to the detriment of other creditors and dependents. Three months worth of cash advances taken in reasonable amounts for necessities easily can exceed $250 and it is inappropriate to presume nondischargeability for this period, particularly when credit card companies are in a superior position to prove the elements of nondischargeability by a preponderance of the evidence. If Congress decides to amend section 523(a)(2)(C) to substantially reduce the dollar threshold triggering a presumption of nondischargeability credit card debts, the presumptive period should be shortened to 30 days and should exclude cash advances.

Sec. 136. Giving debtors the ability to keep leased personal property by assumption.

Under section 136, leased personal property is not property of the estate and is not protected by the automatic stay once a lease is rejected or not timely assumed by the trustee. Section 136 also offers a procedure by which debtors can assume leases themselves. In individual chapter 11 and chapter 13 cases, the lease is deemed rejected at the conclusion of the confirmation hearing, with similar consequences.

COMMENTS: Stating only that this leased property is not property of the estate does not address the fact that the automatic stay protects property of the debtor as well. This provision should be revised to state that leases rejected or not timely assumed are abandoned to the debtors, but should allow debtors an opportunity to cure defaults.

Page 204 PREV PAGE TOP OF DOC

Sec. 137. Adequate protection of lessors and purchase money secured creditors.

Under this section, a chapter 13 debtor must make cash payments at the contract rate to lessors and creditors with debts secured by personal property until the creditors start to receive plan payments. The section also authorizes a lessor or creditor to retain any property rightfully obtained prior to the bankruptcy filing until adequate protection payments are commenced, notwithstanding otherwise applicable turnover requirements. Since trustees may not disburse a debtor's preconfirmation payments to creditors until confirmation, this section requires debtors to make adequate protection payments concurrently with plan payments.

COMMENTS: By requiring that the debtor make regular contract payments to lessors and secured creditors concurrent with repayment plan payments prior to confirmation, this provision imposes an unfeasible requirement that is inconsistent with the goal of encouraging chapter 13 repayment plans. The Bankruptcy Code should not impose an impossible requirement by making debtors pay the same money twice. In addition, the provision potentially triggers *the cessation of adequate protection payments to a lessor by the commencement of payments under the plan to a creditor, which may not be the intended result. See proposed section 1307A(a)(1)(B).*

The Bankruptcy Code already authorizes adequate protection against the declining value of collateral, rendering this provision unnecessary. However, if more is necessary to insure payment of secured creditors pending confirmation of a plan, section 137 should be revised so that courts may instruct trustees to distribute payments to fully secured creditors and lessors prior to confirmation and that those payments are credited against the principal debt. In any event, subsection (d) of proposed section 1307A should be deleted.

Page 205 PREV PAGE TOP OF DOC

[There is no section 138 in the Conference Report]

Sec. 139. Automatic stay.

Section 139, like section 709 of H.R. 3150 as passed by the Senate, creates four new exceptions to the automatic stay that expand the ability of residential landlords to take action against debtors without first seeking leave from the court. Landlords may continue eviction or unlawful detainer actions if the lease terminated prepetition, if the debtor does not paid rent after the commencement of the case, if the debtor filed a previous case within the last year and failed to pay postpetition rent during the course of that case, if the eviction action is based on "endangerment to property or person or the use of illegal drugs."

COMMENTS: The National Bankruptcy Conference generally opposes exceptions to the automatic stay that prefer one type of creditor to others without an adequate policy justification for the distinction. This provision gives wide latitude for landlords to evict individuals filing for bankruptcy, even if the debtor is making rent payments postpetition. If a provision to protect landlords is thought to be necessary, section 139 should be replaced with a provision authorizing landlords to receive expedited relief from the automatic stay. The following provision is an example:

Section 362 of title 11, United States Code is amended by adding at the end thereof—

(j) If a lessor of residential real property makes a request for relief under subsection (d) of this section and the debtor has not paid rent that first became due after the commencement of the case, the stay provided by subsection (a)(3) of this section is terminated with respect to the lessor 20 days after request is filed, unless the debtor files and serves upon such lessor a written objection to the request.

Page 206 PREV PAGE TOP OF DOC

Sec. 140. Extend period between bankruptcy discharges.

This section amends 11 U.S.C. §727(a)(8) to prevent a chapter 7 debtor from receiving a discharge if he received a discharge in a prior case under chapter 7 or 11 commenced within eight years before the filing of the petition in the instant case. If a chapter 13 debtor previously received a discharge under any chapter within the prior five years before the instant case commenced, he cannot receive a discharge even if he completes a new repayment plan.

COMMENTS: This provision imposes a longer bar on the receipt of a discharge after a successful chapter 13 repayment plan than after the discharge of nonpriority unsecured debts in chapter 7.

Sec. 141. Definition of domestic support obligation.

This provision adds a definition of "domestic support obligation" to 11 U.S.C. §101, the general definition section of the Bankruptcy Code. The new definition includes any debt, whether accrued before or after the bankruptcy filing if: the debt is owed or recoverable to a spouse, exspouse, child, legal guardian, or a governmental unit; the debt is in the nature of alimony, maintenance, or support, regardless of its designation, established or subject to establishment by reason of a separation agreement, divorce decree, property settlement agreement, court order, or determination made by a governmental unit; and the debt has not been assigned to a nongovernmental unit, other than a debt collector. This definition is relevant to subsequent provisions that give certain rights to the holders of domestic support obligations and impose additional requirements on debtors who owe these obligations.

Page 207 PREV PAGE TOP OF DOC

COMMENTS: This broad definition, which triggers the application of other provisions, produces higher priority and more entitlements for the government, which collects support for only a fraction of women and children entitled to support. There will be times when the government's interest in collecting past due support will conflict with the interest of an ex-spouse and child in collecting current support. In those cases, broadening the definition will do more to benefit the government than it will to benefit the support recipients.

Sec. 142. Priorities for claims for domestic support obligations.

This section amends 11 U.S.C. §507(a), the provision that determines priorities in distribution among expenses and debts. The amendment moves domestic support obligations from "seventh priority" to "first priority." Because the definition of domestic support obligation now includes debts owed to the government, those government debts are entitled to "first priority" as well. However, the amendment specifies that any first priority distribution should first be applied to satisfy the claims of support recipients and then to government units.

COMMENTS: Right now, the expenses of administering the bankruptcy estate are entitled to ''first priority.'' See 11 U.S.C. §507(a)(1),503(b). The Bankruptcy Code gives first priority to administrative expenses to enable the trustee to incur the expenses necessary to liquidate property and make distributions to creditors, including support recipients. If a debtor has significant support obligations, and support is ''first priority,'' the trustee will not be able to liquidate and distribute property. Instead, the trustee may have to ''abandon''—give back—the property to the debtor instead of distributing the proceeds to support recipients. Thus, while it may be legally correct to say that this bill puts child support ''first'' under section 507 of the Bankruptcy Code, that statement is somewhat misleading. It also is misleading to suggest that moving up to ''first priority'' to ''seventh priority'' makes a significant difference: the debts that have second through sixth priorities almost never appear in consumer cases. Those priorities deal with debts of grain storage facility operators, debts of fishermen, employee wage claims, retail layaway claims, and the like. Taking all factors into consideration, this amendment would have an effect in fewer than 1% of all chapter 7 cases.

Page 208 PREV PAGE TOP OF DOC

Sec. 143. Requirements to obtain confirmation and discharge in cases involving domestic support obligations.

This section amends 11 U.S.C. §1129(a) and 1325(a), provisions that set forth the requirements for confirmation of plans of reorganization in cases under chapter 11 and chapter 13. Under this amendment, the debtor cannot confirm a plan of reorganization unless the debtor has paid all domestic support obligations that "become payable" after the bankruptcy petition is filed.

In addition, this section amends 11 U.S.C. §1328(a), the provision that determines whether a chapter 13 debtor may discharge his debts. Under this amendment, the debtor cannot obtain a discharge after completing payments under a chapter 13 plan unless he certifies that all domestic support obligations have been paid.

COMMENTS: The language of the amendment regarding confirmation may be interpreted in certain instances to require that a debtor pay all past due debts before confirmation of a plan, and doing so may be unfeasible. The requirement to pay all support obligations, potentially including arrears, that become payable post-filing before a plan can be confirmed is made especially difficult by another provision in this bill: section 137 requires that the debtor make ''adequate protection'' payments before confirmation to all car lenders, lessors, and retailers that purportedly hold security interests in the debtor's household goods, or else the debtor will have to surrender all of that property. Requiring the debtor to pay all past due support owed to the government as a condition of discharge may make it more *difficult for a former spouse and children who are trying to collect continued support because the debtor will not have discharged his other debts. It is anomalous that chapter 12 debtors are not subject to the requirements of this provision. Family farmers should have the same obligations to pay domestic support obligations as other debtors.*

Page 209 PREV PAGE TOP OF DOC

Sec. 144. Exceptions to automatic stay in domestic support obligation proceedings.

This section adds additional exceptions to the automatic stay in 11 U.S.C. §362(b). According to these amendments, the automatic stay does not enjoin actions to impose or enforce wage orders for domestic support obligations, the interception of tax refunds, the enforcement of medical obligations, or actions to withhold, suspend, or restrict licenses of the debtor for delinquency in support obligations.

COMMENTS: It is important to permit certain enforcement actions to go forward without bankruptcy court intervention. However, the provision should be clarified so that it permits garnishment for CURRENT support without seeking permission from the bankruptcy court. Current law already permits garnishment for current support and arrears in chapter 7 cases.

Sec. 145. Nondischargeability of certain debts for alimony, maintenance, and support.

This section amends 11 U.S.C. §523(a)(5) to except from discharge all domestic support obligations as now defined in section 141.

This section also makes a substantial change to 11 U.S.C. §523(a)(15). This provision currently permits a court to find that a property settlement (that is not in the nature of support) is excepted from discharge *unless* the court finds (1) that the debtor does not have the ability to pay the obligation or (2) that discharging the debt would result in a benefit to the debtor that outweighs the detrimental consequences to the ex-spouse or children. The amendment eliminates these two conditions so that all property settlements will be nondischargeable.

Page 210 PREV PAGE TOP OF DOC

COMMENTS: There will be times when this change to the treatment of property settlements works real hardship on spouses and children collecting support. Debtors are not all deadbeat parents; sometimes a custodial parent and child file for bankruptcy after they have difficulty collecting payments from a deadbeat spouse and thus cannot meet their day to day obligations. As a result of this amendment, some financially troubled spouses and children who file for bankruptcy because they have not been receiving their support payments will be unable to discharge debts they may owe to their wealthier spouses as a result of a property settlement. In addition, some ex-spouses do not receive support because they are financially independent or have remarried and joined financial stable households. In such a case, there may not be a public policy reason to make a property settlement debt nondischargeable to the remarried spouse when doing so would work extreme hardship on the debtor. Another scenario that reveals the odd effects of this amendment is when a debtor has been married and divorced twice. The first former spouse may need child support from the debtor. The second former spouse may be wealthy and remarried and does not receive support from the debtor but has a property settlement with the debtor. If this amendment becomes law, the support obligation to the first spouse and the property settlement to the second spouse would both be nondischargeable and have the same status after bankruptcy; if the debtor lacks sufficient funds to pay both, the support recipient, who has fewer resources to seek collection, may suffer.

Sec. 146. Continued liability of property.

This amendment permits nondischargeable domestic support obligations to be collected from property—even property that state law makes exempt from collection or attachment—after bankruptcy.

Page 211 PREV PAGE TOP OF DOC

COMMENTS: This provision violates states' rights to govern the exemption of property after bankruptcy. It overrides wage exemptions, property exemptions, and state laws protecting tenancies by the entireties. It is unclear whether this provision actually will benefit families or whether it instead will benefit government agencies, particularly because overriding homestead exemptions may have the effect of removing families from their homes.

Sec. 147. Protection of domestic support claims against preferential transfer motions.

This section amends 11 U.S.C. §547, the provision that allows avoidance, and ultimately recovery, of pre-bankruptcy transfers that were "preferential." The amendment prevents a trustee from seeking recovery of a prepetition "domestic support obligation."

COMMENTS: With respect to actual support recipients, this amendment does not substantially change current law. A 1994 amendment protects exspouses and children from having to give back "preferential" support payments. See 11 U.S.C. §547(c)(7). Now, the provision insulates preferential payments made to governmental units. Insulating those payments to the government may, in some cases, hurt an exspouse and child of the debtor because those funds otherwise would be available for ongoing support payments and instead have been applied to old support debts preferentially paid to the government.

Sec. 148. Definition of household goods and antiques.

Section 148 contains an exhaustive list of what items (and how many of those items) are household goods for purposes of lien avoidance under 11 U.S.C. §522(f). According to this list, electronic entertainment equipment is not a household good except for "one television, one radio, and one VCR." A computer is a household good only if it is used primarily for the education or entertainment of minor children.

Page 212 PREV PAGE TOP OF DOC

COMMENTS: This section should be deleted because it is nearly impossible to construct an exhaustive list of goods that appropriately accounts for all types of families and circumstances, and this provision first appeared in the Conference Report. Judges should retain the discretion to determine whether an item is a household good for purposes of lien avoidance.

Sec. 149. Nondischargeable debts.

This section adds another exception to discharge when the "debtor incurred the debt to pay such a nondischargeable debt with the intent to discharge in bankruptcy the newly-created debt." It makes nondischargeable any debts incurred to pay nondischargeable debts within 90 days without any intent requirement.

COMMENTS: The National Bankruptcy Conference opposes this exception to discharge, particularly the portion that excepts from discharge all debts incurred to pay nondischargeable debts within 90 days prior to filing. For a credit card debt to be nondischargeable, a creditor should be required to file an adversary proceeding and prove each element of fraud by the preponderance of the evidence. As a technical matter, the reference in the amendment to section 727 is incorrect and should be deleted.

TITLE II.

Sec. 201. Reenactment of chapter 12.

Page 213 PREV PAGE TOP OF DOC

This section reenacts chapter 12, which expired on October 1, 1998, and states that the reenactment shall take effect on October 1, 1998.

COMMENTS: The National Bankruptcy Conference has submitted a statement jointly with the Commercial Law League of America and the American College of Bankruptcy that endorses freestanding bills that make chapter 12 permanent so that the opportunity for family farmer reorganization need not wait deliberation over this controversial omnibus reform bill.

Sec. 202. Meetings of creditors and equity security holders.

Under this section, the court is authorized to waive the requirement of a section 341 meeting of creditors after notice and a hearing if the debtor files a prepackaged plan of reorganization.

COMMENTS: The National Bankruptcy Conference supports this provision, which will enhance the efficiency of prepackaged plans of reorganization. However, the Conference recommends that the proposed section 341(e) reads in accordance with the following amendment:

Section 341 of title 11, United States Code, is amended by adding at the end the following—

''(e) Notwithstanding subsections (a) and (b) in a case under chapter 9 or 11 of this title in which a plan has been filed for which, before the meeting of creditors or equity security holders under this section, a hearing on confirmation has been scheduled, on the request of a party in interest and after notice and a hearing, the court may order that the United States trustee postpone the meeting pending the hearing on confirmation, and, if the plan is confirmed, order that the meeting not be held.''

Page 214 PREV PAGE TOP OF DOC

Sec. 203. Protection of retirement savings in bankruptcy.

Like section 330 of H.R. 3150 as passed by the Senate, this provision amends 11 U.S.C. §522 to exempt qualified retirement funds that are exempt from taxation under various provisions of the Internal Revenue Code. This provision makes the automatic stay inapplicable to wage deductions for pensions, profit sharing or other such plans to the extent that those amounts are used solely for payments relating to a loan from an ERISA qualified plan, except for debts incurred within 1 year prior to filing a bankruptcy petition. In addition, loans borrowed from retirement plans are excepted from discharge under section 523(a), except for loans made within 1 year prior to filing the bankruptcy petition. Finally, section 1322 is amended to provide that a chapter 13 plan may not "materially alter" the terms of a loans from retirement funds.

COMMENTS: The National Bankruptcy Conference supports this provision, subject to some minor technical revisions. The following language should be added to the end of the section 1325 amendment: ''For purposes of the plan only, any such loan shall be treated as a nonrecourse loan secured by the assets of the applicable pension, profitsharing, stock bonus, or other plan. No plan established under sections 401, 403, 408(A), 414, 457, or 501(c) of the Internal Revenue Code of 1986 or permitted under the Employment Retirement Income Security Act may be disqualified as a result of the repayment of any loan to such plan made in accordance with a confirmed plan under this chapter.''.

Sec. 204. Protection of refinance of security interest.

Page 215 PREV PAGE TOP OF DOC

This provision amends 11 U.S.C. §547(e)(2) so that a transfer is deemed to be made at the time such transfer takes effect between the transferor and the transferee if the transferee perfects its interest within 30 days, rather than 10 days.

COMMENTS: The National Bankruptcy Conference opposes this provision. This substantial and excessive extension *of the relation-back period may harm the interests and unfairly trap creditors who extend credit in reliance on the lack of a perfected security interest in specified collateral.*

Sec. 205. Executory contracts and unexpired leases.

Section 205 amends 11 U.S.C. §365(d)(4) to replace the 60-day period with a 180-day period to assume or reject a nonresidential real property lease. After 180 days, the court may extend the deadline only on the motion of the lessor, unlike current law that permits the court to extend the deadline for cause.

COMMENTS: The National Bankruptcy Conference opposes this provision. This provision will preclude the reorganization of some businesses and will force some debtors in possession to make premature decisions regarding their leases, to the potential detriment of other creditors if the business ultimately is liquidated. See In re Klein Sleep Prods., 78 F.3d 18 (2d Cir. 1996) (obligations under assumed lease are entitled to administrative expense priority, even if lease is later rejected). If the provision is retained in its current form, post-180 day extensions should be triggered by the request, not by the motion, of the lessor. Ideally, however, section 205 instead should read as follows:

Page 216 PREV PAGE TOP OF DOC

Section 365(d)(4) of title 11, United States Code, is amended by adding at the end the following—

''The court may not extend the period during which the trustee or plan proponent must elect to assume or reject a lease of nonresidential real property beyond the date of entry of the order confirming the plan, but such assumption or rejection may occur on or before the earlier of—

(A) the effective date of the plan;

(B) conversion of the case; or

(C) dismissal of the case.''.''

Sec. 206. Creditors and equity security holders committees.

Section 206 clarifies that courts may review appointments to creditors' and equity security holders' committees to ensure adequate representation of creditors or equity security holders.

COMMENTS: The National Bankruptcy Conference supports this provision, which resolves a split in the case law and recognizes that adequate representation is a question of law for which parties should have legal redress.

Sec. 207. Amendment to section 546 of title 11, United States Code.

Page 217 PREV PAGE TOP OF DOC

This section prohibits a trustee from avoiding a warehouseman's lien for storage, transportation or other costs incidental to the storage and handling of goods, notwithstanding the trustee's otherwise applicable power to avoid those liens under 11 U.S.C. §545.

COMMENTS: To the extent that a statutory lien protected by this provision would be ineffective against a bona fide purchaser, the National Bankruptcy Conference opposes this amendment. Substantive issues aside, the amendment should be made to 11 U.S.C. §546(i), not section 546(I), and the first line ''(I) Notwithstanding section 545 (2) and (3)'' should be deleted and substituted with ''(i) Notwithstanding section 545(2) [no space between 545 and (2)] and 545(3).''

Sec. 208. Limitation.

This section extends the reclamation period under 11 U.S.C. §546(c)(1)(B) from 20 to 45 days.

COMMENTS: The National Bankruptcy Conference opposes unwarranted expansion of reclamation rights that is prejudicial to the interests of other creditors and to the estate. This extension to 45 days does not appear to take into consideration the tracing requirement imposed by case law.

Sec. 209. Amendment to section 330(a) of title 11, United States Code.

Page 218 PREV PAGE TOP OF DOC

This section amends 11 U.S.C. §330(a) so that the factors guiding courts in awarding compensation apply specifically to examiners, chapter 11 trustees, and professional persons. When determining trustees' compensation, the court "shall treat such compensation as a commission based on the results achieved."

COMMENTS: To more effectively fulfill the intent of this provision, 11 U.S.C. §330 should be revised to strike the first (A) after paragraph (3) to avoid the extraneous reference (there are two paragraphs designated (A) and the first is unnecessary). Paragraph (2) of this amendment should added as a new subparagraph (F) in section 330(a)(3) that reads "whether the compensation is reasonable compensation as a commission based on the results achieved." Paragraph (1) of this amendment then should be deleted as unnecessary. Thus, section 209 of this bill should read as follows:

Section 330(a)(3) of title 11, United States Code, is amended—

(1) by deleting the first "(A)" that appears;

(2) in subparagraph (D) by striking "; and" at the end;

(3) in subparagraph (E) by inserting "and" at the end; and

(4) by adding at the end the following:

"(F) whether the compensation is reasonable as a commission based on the results achieved.".

Page 219 PREV PAGE TOP OF DOC

Sec. 210. Postpetition disclosure and solicitation.

This section permits postpetition solicitation of votes prior to court approval of a disclosure statement in a prepackaged plan of reorganization, but only for holders of claims solicited prior to commencement of the case in accordance with applicable nonbankruptcy law.

COMMENTS: The National Bankruptcy Conference supports this provision. However, the Conference recommends that the amendment be revised as follows:

Section 1125 of title 11, United States Code, is amended by adding at the end the following—

"(g) Notwithstanding subsection (b), an acceptance or rejection of the plan may be solicited from a holder of a claim or interest if such solicitation complies with applicable nonbankruptcy law and if the solicitation began before the commencement of the case and was in compliance with any applicable nonbankruptcy law, rule, or regulation governing the adequacy of disclosure in connection with the solicitation or, if there is not any such law, rule, or regulation, the solicitation occurred after disclosure of adequate information to the solicited holders."

Sec. 211. Preferences.

This provision broadens the availability of the ordinary course of business defense to preference actions under 11 U.S.C. §547(c)(2) by de-coupling the requirement that a transaction be in the ordinary course of business between the debtor and creditor and in accordance with ordinary business terms for the industry at large. This means that the recipient of a payment that was not in the ordinary course between the debtor and the creditor will not be required to return the payment for the benefit of all creditors. This section also precludes trustees from brining preference actions to recover less than $5,000 in aggregate transfers to noninsider creditors in cases that do not involve primarily consumer debts.

Page 220 PREV PAGE TOP OF DOC

COMMENTS: The ordinary course amendment increases the difficulty of avoiding preferential transfers in the business context, and other creditors may receive smaller distributions as a consequence. Whether or not the test is made disjunctive, section 547(c)(2)(B) should amended to read ''made in the ordinary course of business or financial affairs of the debtor and the transferee AND MADE AT A TIME WHEN THE DEBTOR WAS GENERALLY PAYING THE DEBTOR'S DEBTS AS THEY BECAME DUE'' to help ensure that truly preferential transfers are not insulated from avoidance.

The threshold dollar limitation is unobjectionable.

Sec. 212. Venue of certain proceedings.

This section amends 28 U.S.C. §1409 so that a trustee may commence a preference action to recover a nonconsumer debt of less than $10,000 only in the district in which the noninsider creditor resides.

COMMENTS: This provision is unobjectionable, but is inconsistent with the venue provision applicable to recovery of consumer debts, which permits actions for more than $5,000 to be brought in other districts.

Sec. 213. Period for filing plan under chapter 11.

This section limits the ability of a debtor in possession to obtain extensions of its exclusive right to file a chapter 11 plan to 18 or 20 months, respectively. The amendment provides no discretion for judges to permit longer periods of exclusivity under appropriate circumstances.

Page 221 PREV PAGE TOP OF DOC

COMMENTS: The National Bankruptcy Conference opposes this provision. This amendment does not provide the requisite flexibility to permit longer periods of exclusivity under compelling circumstances. Although plans are confirmed more quickly now than in the 1980s, the exclusivity period in successful larger cases averages longer than 18 to 20 months. Inflexible limits on exclusivity will squelch negotiations long before the exclusivity periods expire, as creditors exert leverage with the threat of a competing plan. More debtors in possession will seek confirmation of nonconsensual plans, a costly and undesirable result. Under the 1994 amendments, district courts have jurisdiction to hear appeals from orders increasing the exclusivity period, 28 U.S.C. §158(a)(2), which should be utilized to address unwarranted extensions of exclusivity.

Sec. 214. Fees arising from certain ownership interests.

Section 214 amends 11 U.S.C. §523(a)(16) to expand this exception to discharge by encompassing condominium fees and assessments regardless of whether the debtor or a tenant continues to occupy the unit.

COMMENTS: The National Bankruptcy Conference opposes exceptions to discharge providing preferential treatment for certain creditors to the detriment of others without a sound policy justification. If a debtor is not using *the condominium due to foreclosure or other circumstances, condominium fees for that period should not be excepted from discharge.*

Sec. 215. Claims relating to insurance deposits in cases ancillary to foreign proceedings.

Page 222 PREV PAGE TOP OF DOC

This section amends 11 U.S.C. §304 to provide that the court may not grant relief under the new transnational chapter with respect to any deposit, escrow, trust funds, or other security required or permitted under any applicable State insurance law or regulation for the benefit of claim holders in the United States.

COMMENTS: This provision has been improved by the comments of those on the United Nations International Commission on Trade Law who developed the model law for cross border insolvency. However, this provision makes a significant change that requires further study before being included in legislation.

Sec. 216. Defaults based on nonmonetary obligations.

This section amends 11 U.S.C. §365(b)(2) to clarify the requirements to cure non-monetary defaults on executory contracts and leases, an issue that arose in part from the line of cases culminating in Worthington v. General Motors Corp. (*In re* Claremont Acquisition Corp.), 113 F.3d 1029 (9th Cir. 1997). According to this amendment, a trustee's requirement to cure does not apply to a penalty rate or penalty provision relating to a default arising from a failure to perform nonmonetary obligations under an executory contract or under an unexpired lease of real or personal property, although unlike H.R. 3150 as passed by the House of Representatives, this waiver does not apply to executory contracts that transfer a right or interest under a filed or issued patent, copyright, trademark, trade dress, or trade secret. The trustee's requirement to cure also does not apply to the satisfaction of any other provision relating to a default arising from any failure to perform nonmonetary obligations under a nonresidential real property lease or executory contract, if it is impossible for the trustee to cure such default by performing nonmonetary acts at and after the time of assumption and, in the case of an executory contract, if the court determines based on the equities of the case that the requirements to cure should not apply with respect to such default. In addition, this section eliminates the now-defunct provisions in section 365 addressing aircraft gate and terminal leases.

Page 223 PREV PAGE TOP OF DOC

This section also makes a conforming change regarding nonmonetary defaults to 11 U.S.C. §1124(2), which governs the impairment of claims and interests in chapter 11.

COMMENTS: The National Bankruptcy Conference supports this provision generally, but opposes the language that excludes intellectual property contracts from its scope. The intellectual property exception ignores the possibility that the debtor is the intellectual property licensor rather than the licensee. If the licensor cannot assume the contract, the nondebtor party may be deprived of rights except to the extent protected under section 365(n). Moreover, if the debtor is the licensee, there is no reason why a technical prepetition default on a nonmonetary obligation, such as going dark or a conducting a going out of business sale, should justify forfeiting the debtor's access to the intellectual property as long any other defaults have been cured. If some additional protection is desired, the balancing test used in the provision for executory contracts should be sufficient.

It is appropriate to eliminate the defunct provisions addressing aircraft gate and terminal leases, but this deletion requires renumbering and cross referencing of the remaining paragraphs of those subsections.

Sec. 301. Definition of disinterested person.

This section amends the definition of disinterested person in 11 U.S.C. §101(14) to eliminate the per se disqualification of investment bankers.

COMMENTS: The National Bankruptcy Conference does not have a position on this provision.

Page 224 PREV PAGE TOP OF DOC

Sec. 302. Miscellaneous improvements.

This provision amends 11 U.S.C. §109 so that an individual may not be a debtor in bankruptcy unless the individual has received credit counseling within 90 days before the date of the petition. Credit counseling includes, at a minimum, participation in a briefing that outlines the opportunities for counseling and assists that individual in an initial budget analysis. Debtors must file a certificate from the credit counseling service and a copy of the debt repayment plan, if any. The prebankruptcy counseling requirement does not apply if the United States trustee determines that the approved services for that district are not reasonably able to provide adequate services to those seeking counseling as a bankruptcy prerequisite. This determination must be reviewed by the United States trustee on an annual basis. The counseling requirement also may be waived by the court if a debtor certifies the existence of exigent circumstances and states that the debtor requested counseling services but was unable to obtain services for a five day period. This exemption expires 30 days after the debtor files a petition for relief. This provision also offers a rebuttal to the proposed presumptions of bad faith repeat filings if the prior case was dismissed due to the creation of a debt repayment plan.

This section also conditions receipt of a chapter 7 and chapter 13 discharge on the completion of a financial management course. The chapter 13 requirement does not apply if the United States trustee determines that the approved courses are not adequate to service those individuals who are seeking education as a condition of discharge.

This section also defines the debtor's principal residence, stating that it is "a residential structure, including incidental property, without regard to whether that structure is attached to real property." Incidental property is defined as "property commonly conveyed with a principal residence" and "all easements, rights appurtenances, fixtures, rents, royalties, mineral rights, oil or gas rights or profits, water rights, escrow funds, or insurance proceeds" and "all replacement or additions."

Page 225 PREV PAGE TOP OF DOC

Finally, this provision amends 11 U.S.C. §362 to provide an exception to the presumption created in section 119 of this bill that repeat filings are not in good faith if the first case was dismissed due to the postpetition creation of a debt repayment plan.

COMMENTS: A prebankruptcy counseling requirement is not objectionable as long as the court retains adequate discretion to waive the requirement if it would be an undue hardship, particularly because pro se debtors are unlikely to be aware that counseling is a precondition to filing a bankruptcy petition.

The implementation of a mandatory financial management course should be deferred until completion of the pilot programs established in section 105 of this bill.

The definition of debtor's principal residence should exclude mobile homes, which depreciate and are subject to extensions of credit priced like consumer loans instead of mortgage loans:

Section 1322 of title 11, United States Code, is amended by adding at the end:
"(f) For purposes of subsections (b)(2) and (c)(2) of this section"

"(1) 'real property' includes personal property that is used in and is an integral part of the real property, including property commonly conveyed with a principal residence in the area where the real estate is located and all related easements, rights, appurtenances, fixtures, rents, royalties, mineral rights, oil or gas rights or profits, water rights, escrow funds, or insurance proceeds; and

Page 226 PREV PAGE TOP OF DOC

"(2) 'principal residence' does not include a mobile home, trailer, or other form of manufactured housing that by its design is moveable.

The exception to the presumption that a repeat filing is not in good faith, if retained, should be revised to avoid the use of a double negative. The provision might be easier to read if it stated: "If a case commenced under chapter 7, 11, or 13 of this title is dismissed due to the creation of a debt repayment plan, and if a subsequent case is commenced within two years under chapter 7, 11 or 13 of this title, the creation of a debt repayment plan rebuts the presumption that the subsequent case was not filed in good faith."

Sec. 303. Extensions.

This provision extends the Bankruptcy Administrators' program in Alabama and North Carolina.

The districts in those states therefore would not be part of the U.S. trustee program.

COMMENTS: The National Bankruptcy Conference opposes this amendment, which encourages nonuniformity and undermines the efficacy of the United States Trustee system. This provision gives rise to Constitutional concerns, which may affect this legislation in its entirety. See Angelo v. Victoria Farms, Inc., 38 F.3d 1525 (9th Cir. 1994) (delaying implementation of United States trustee program in North Carolina and Alabama violates United States Constitution).

Page 227 PREV PAGE TOP OF DOC

TITLE IV.(see footnote 14)

Sec. 401. Flexible rules for disclosure statement and plan.

As part of the small business provisions, this section authorizes courts to waive or modify the requirement that a chapter 11 debtor in possession file a disclosure statement that is approved as a prerequisite to soliciting votes on a plan of reorganization. The provision permits the court to conditionally approve disclosure statements and to combine the disclosure statement hearing with the confirmation hearing.

COMMENTS: Proposed section 1125(f)(1) should apply to all chapter 11 debtors, not just small business debtors.

Sec. 402. Definitions.

This section amends the definition of small business debtor to apply in cases involving debts of $4 million or less. Unlike prior versions of this provision, section 402 does not include single asset real estate. In addition, this provision apparently intends to exclude businesses with active creditors' committees. Due to a drafting error, however, the provision applies only to cases with active creditors' committees.

This section also contains text that duplicates part of section 116 of the bill, amending 11 U.S.C. §524 to penalize violations of the discharge injunction and to restrict the ability to recover under section 524 through a class action.

Page 228 PREV PAGE TOP OF DOC

COMMENTS: A drafting error makes the small business definition apply only to cases with active creditors' committees. The single quotation marks around "the court determines" should be deleted and the word "not" should be added before "sufficiently active and representative" in the proposed definition of small business. The misplaced text amending 11 U.S.C. §524 should be omitted.

Technical problems aside, this provision has improved over the House and Senate versions by lowering the debt cap, incorporating single asset real estate debtors only if they fall within the debt cap, and attempting to carve out businesses with active creditors committees. However, the $4 million cap should be reduced to $2 million. In addition, *some of the provisions applicable to small business debtors remain troublesome, as discussed in commentary on subsequent sections.*

Sec. 403. Standard form disclosure statement and plan.

Section 403 orders the Advisory Committee on Bankruptcy Rules of the Judicial Conference of the United States to devise and adopt uniform forms for disclosure statements and plans of reorganization for debtors falling within the small business definition. The section advises that the rules should achieve a practical balance between parties' reasonable needs for complete information and economy and simplicity for debtors.

COMMENTS: Standard forms for disclosure statements should be developed carefully to take into account the distinctions in disclosure necessary for various types of business debtors.

Page 229 PREV PAGE TOP OF DOC

Sec. 404. Uniform national reporting requirements.

This provision requires that a small business debtor file periodic financial reports, including information on profitability, projected cash receipts and disbursements, comparisons of actual receipts and disbursements with prior projections, whether the debtor is in compliance with postpetition requirements and has filed tax returns and paid taxes and other administrative claims, and other matters in the best interest of all parties.

COMMENTS: Papers of this nature should be filed with the United States trustee, not with the court. This provision should be simplified and combined with section 406 of this bill.

Sec. 405. Uniform reporting rules and forms for small business cases.

This provision gives responsibility to the Advisory Committee on Bankruptcy Rules of the Judicial Conference of the United States to propose for adoption the establishment of rules and forms to elicit information regarding such matters as the debtor's profitability, cash receipts and disbursements, and whether the debtor is timely filing tax returns and paying taxes and administrative claims when due.

COMMENTS: Any rules and forms adopted should be simple and should elicit pertinent information without being unduly burdensome.

Sec. 406. Duties in small business cases.

Page 230 PREV PAGE TOP OF DOC

Section 406 imposes duties on the small business debtor in possession to file additional information, attend through its senior management and counsel meetings with the United States trustee and the court (unless the court waives this requirement on a finding of extraordinary and compelling circumstances), timely file all schedules and statements of financial affairs unless the court grants a limited extension due to extraordinary and compelling circumstances, file all reports, maintain insurance, timely file tax returns, pay all administrative expense tax claims, establish separate deposit accounts for taxes (unless the court waives this requirement for extraordinary and compelling circumstances), and allow the United States trustee to inspect the business premises and books and records.

COMMENTS: This provision has improved marginally over prior versions by permitting courts to waive some requirements in compelling circumstances, although ''compelling'' imposes a rather high threshold to waiver. ''Reasonable justification'' is a more appropriate standard. More feasible deadlines should be set for these duties, and many of the required documents should be submitted to the United States trustee, not the court. Mentioning requirements to pay taxes might create a negative implication regarding a debtor's other duties not mentioned in this provision, such as wage claims.

Sec. 407. Plan filing and confirmation deadlines.

This section limits the exclusivity period for small business debtor cases to 90 days and requires that the small business debtor file a plan of reorganization within 90 days after filing for bankruptcy. This period may be shortened on request of a party in interest. To obtain an extension, the debtor must demonstrate prior to the expiration of the deadline "by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable time."

Page 231 PREV PAGE TOP OF DOC

COMMENTS: As currently drafted, this provision may prevent the habilitation of viable small businesses. The extension standard is unrealistic for small businesses, particularly those with operational problems or seasonal businesses, and will force viable businesses to attempt confirmation of poorly-drafted or ill-conceived plans or to liquidate to the detriment of employees, suppliers, and others. Secured creditors also might be able to use the time restrictions as leverage to obtain more favorable treatment to the detriment of unsecured creditors.

Small businesses should be entitled to extensions for cause, as long as the plan filing limitation can be extended only if doing so would be in the best interests of the creditors and the estate.

Sec. 408. Plan confirmation deadline.

Under this section, plans of small business debtors must be confirmed no later than 150 days after the date of the order for relief. Extensions are available only if the debtor meets the burden for an extension stated in section 407.

COMMENTS: The court should be permitted to grant an extension if doing so would be in the best interests of creditors and the estate. Doing otherwise will prevent many small businesses from reorganizing even if by all accounts they are worth saving.

Sec. 409. Prohibition against extension of time.

Page 232 PREV PAGE TOP OF DOC

Section 409 amends 11 U.S.C. §105(d) to prohibit a court from exercising its discretion to extend a deadline in a manner inconsistent with sections 407 and 408.

COMMENTS: This provision should be deleted. By negative implication, it suggests that the court may override other statutory deadlines.

Sec. 410. Duties of the United States trustee.

Pursuant to this provision, the U.S. trustee (or bankruptcy administrator) is vested with new statutory duties in small business debtor cases, including the duty to conduct "initial debtor interviews" during which the U.S. trustee investigates the debtor's viability and business plan. The U.S. trustee must inspect the debtor's premises, must diligently monitor the debtor's activities to identify whether the debtor will be unable to confirm a plan, and must promptly seek relief on discovering material grounds for conversion or dismissal under 11 U.S.C. §1112, as revised by section 412 of this bill.

COMMENTS: Although some of the duties delineated in this section are appropriate and codify some current United States trustee practices, the assessment of business viability should not fall upon the United States trustee, who already is vested with a variety of administrative responsibilities.

Sec. 411. Scheduling conferences.

Section 411 amends 11 U.S.C. §105(d) to require courts to hold status conferences as necessary to further the "expeditious and economical resolution of the case."

Page 233 PREV PAGE TOP OF DOC

COMMENTS: This provision is unobjectionable.

Sec. 412. Serial filer provisions.

Although the language may not accomplish the intended result, section 412 apparently is designed to withhold application of the automatic stay for a small business that files a bankruptcy petition within two years after a prior chapter 11 plan was confirmed, or within two years after the entry of a dismissal order in a prior chapter 11 case. If the former owners of a prior small business debtor have transferred the business to a successor entity, the automatic stay is inapplicable unless the debtor can prove by a preponderance of the evidence that the new case resulted from circumstances beyond the control of the debtor not foreseeable at the time the first case was filed and that "it is more likely than not" that the debtor will confirm a feasible plan, but not a liquidating plan, within a reasonable time. The provision also limits damages for violations of the automatic stay based on a good faith belief that there was no stay in a subsequent small business bankruptcy case.

COMMENTS: As drafted, this provision withholds automatic stay application in all cases except certain involuntary cases, which probably was not intended. To address this problem, proposed subsection (j) to section 362 should be revised to state that ''The filing of a petition under chapter 11 of this title does not operate as a stay in a case in which the debtor—''.

In addition, bona fide purchasers of a debtor's assets that subsequently file for bankruptcy should not be subject to the restrictions on the automatic stay. To address this problem, the term ''entity'' in subsection (j)(4) should be replaced with ''insider.'' In addition, ''in which a discharge is not entered'' should be added to the end of (j)(1); otherwise, ''pending'' is too ambiguous.

Page 234 PREV PAGE TOP OF DOC

Sec. 413. Expanded grounds for dismissal or conversion and appointment of trustee.

This section amends 11 U.S.C. §1112(b) to provide that a court *shall* convert or dismiss a case, whichever is in the best interest of creditors and the estate, when a movant establishes "cause," and to enumerate additional grounds for cause. Requests for dismissal or conversion shall not be granted if the debtor objects and establishes that "it is more likely than not" that a plan will be confirmed within a time fixed by statute or by court order; *and*, if "cause" is an act or omission of the debtor, that there exists a reasonable justification for the act or omission *and* that the act or omission will be cured within a reasonable time fixed by the court not to exceed 30 days after the court decides the motion (unless the movant expressly consents to a continuance for a specific period of time or compelling circumstances beyond the debtor's control justify an extension beyond 30 days). Section 413 also authorizes the appointment of a trustee instead of conversion or dismissal if the court determined this would be in the best interest of the estate.

COMMENTS: These significant changes to 11 U.S.C. §1112 apply to all chapter 11 debtors, not just small business debtors. Unlike the current language of section 1112, which makes dismissal or conversion discretionary, dismissal or conversion under the proposed revision are mandatory upon the presence of factors that may not be sufficiently material to warrant this response. As a result, this provision makes one of the most drastic changes in the set of small business proposals.

Sec. 414. Study of operation of title 11 of the United States code with respect to small businesses.

Page 235 PREV PAGE TOP OF DOC

This provision requires the Small Business Administration, in consultation with other parties, to study the causes of small business bankruptcies and how the bankruptcy system can be improved to help small businesses reorganize. This study must be conducted not later than 2 years after the enactment of this bill, and a report must be submitted to the House and Senate.

COMMENTS: This provision is unobjectionable, but will require funding.

Sec. 415. Payment of interest.

This section amends 11 U.S.C. §362(d)(3) to provide explicitly that the debtor can make the requisite payments from rents generated by the property. The section also changes the applicable interest rate to the nondefault contract rate and amends the deadline so that payments must be commenced or a plan filed on the later of 90 days after the petition date or 30 days after the court determines that the debtor is subject to these provisions to account for circumstances in which it is not immediately determined that the debtor is a single asset real estate debtor.

COMMENTS: The National Bankruptcy Conference supports this provision.

TITLE V.

Page 236 PREV PAGE TOP OF DOC

Sec. 501. Petition and proceedings related to petition.

This section clarifies that a chapter 9 petition constitutes an order for relief.

COMMENTS: To effectuate the intent of this provision, the text of section 501 should be replaced with the following:

Section 921 of title 11, United States Code, is amended by—

(1) striking subsection (d); and

(2) redesignating subsection (e) as subsection (d).

Otherwise, the provision will continue to require an unnecessary hearing.

Sec. 502. Applicability of other sections to chapter 9.

This provision amends 11 U.S.C. §901 to extend the application to chapter 9 of certain provisions of chapter 5 of the Bankruptcy Code that relate to the liquidation of securities contracts and the termination of swap agreements.

COMMENTS: The National Bankruptcy Conference supports this amendment.

Page 237 PREV PAGE TOP OF DOC

TITLE VI.

Sec. 601. Creditor representation at first meeting of creditors.

This section permits nonlawyer creditor representatives to appear and participate in section 341 meetings notwithstanding local court rules, State constitution provisions, or other laws to the contrary.

COMMENTS: This amendment conflicts with the laws of some states under which participation at section 341 meetings is the practice of law. See In re Maloney, 209 B.R. 844 (Bankr. M.D. Pa. 1997) (examining debtor at section 341 meeting constitutes practice of law under Pennsylvania law); but see State Unauthorized Practice of Law Committee v. Paul Mason & Assoc., 46 F.3d 469 (5th Cir. 1995) (administrative functions handled by nonlawyer creditor representatives did not constitute unauthorized practice of law under Texas law).

Sec. 602. Audit procedures.

Under section 602, no fewer than 1 in 250 individual debtor cases in each judicial district must be selected randomly for audit, with procedures to be set by the Attorney General, although the audits must be in accordance with generally accepted auditing standards and performed by accountants. Cases also must be audited if the schedules show income and expenses reflecting greater than average variances from the district norm. Material misstatements could lead to revocation or denial of discharge or criminal referrals.

Page 238 PREV PAGE TOP OF DOC

COMMENTS: The National Bankruptcy Conference supports the implementation of an audit process, but recommends that it be structured like section 307 of H.R. 3150 as passed by the Senate by a vote of 97 to 1. The audit system should not rely on accountants to conduct the audits, for the audits most likely will not focus on books and records. Audits also should specifically target high end cases that vary from the statistical norm, but not cases that vary from the statistical norm on the low end (e.g., very low income and/or expenses). Cased filed by individuals under chapters 11 and 12 also should be audited. Realistically, one out of every thousand cases should be audited.

To complement the auditing proposal, the Advisory Committee on Bankruptcy Rules of the Judicial Conference of the United States should propose an amendment to Rule 1017 of the Federal Rules of Bankruptcy Procedure that strikes ''substantial'' and inserts ''clear'' in lieu thereof and that inserts ''or 60 days following the conclusion of an audit under section 586(a)(4) of title 28 of the United States Code, whichever is later'' immediately after ''341(a)'' each place it appears.

Sec. 603. Giving creditors fair notice in chapter 7 and 13 cases.

This provision amends 11 U.S.C. §342 to require that notice to a creditor includes account numbers and specific addresses or agents listed on the "last communication before the filing of the petition from the creditor to a debtor." Like section 309 of H.R. 3150 as passed by the Senate, this provision also creates a court filing registry for designated addresses. This provision also delineates a new set of debtor duties to be added to 11 U.S.C. §521, primarily comprised of informational requirements, such as tax returns and income statements. This provision also directs the Administrative Office of the United States Courts to establish procedures safeguarding the confidentiality of tax information within 30 days after the date of enactment and to submit a report to Congress on this mater within a year after the date of enactment.

Page 239 PREV PAGE TOP OF DOC

COMMENTS: The court filing registry should be the primary means of ensuring that notice is sent to creditors at the address of their choosing. The remainder of the provision dealing with notice should be deleted. The informational requirements should not come into effect until the Administrative Office of the United States Courts have implemented a procedure to safeguard the privacy of tax information. Proposed subsections (g) and (h) should be redesignated as subsections (e) and (f).

Sec. 604. Dismissal for failure to timely file schedules or provide required information.

This section amends 11 U.S.C. §521 so that cases are dismissed automatically if individual debtors do not submit all required information within the statutory deadline. Extensions of up to 45 days may be granted if a court finds a "justification" to do so.

COMMENTS: The 45 day extension makes this provision much more reasonable than it was in its original form, particularly considering that the need to obtain information from the Internal Revenue Service may hinder a debtor's ability to comply in a timely fashion. Proposed subparagraph (3), which states ''period of not to exceed'', should be revised to state ''period not to exceed''.

Sec. 605. Adequate time to prepare for hearing on confirmation of the plan.

Under section 605, 11 U.S.C. §1324 is amended to provide that a confirmation hearing may be held no earlier than 20 days (and no later than 45 days) after the section 341 meeting if a creditor objects to the confirmation of a plan.

Page 240 PREV PAGE TOP OF DOC

COMMENTS: Although not objectionable by itself, this provision could have prolong the time during which a debtor is required to make adequate protection payments under section 137 of this bill concurrently with plan payments.

Sec. 606. Chapter 13 plans to have a 5-year duration in certain cases.

Section 606 intends to impose a five year duration requirement for chapter 13 plan for debtors with income not less than the highest national median income for a family of equal or lesser size.

COMMENTS: Extending the duration of chapter 13 plans is a curious and questionable policy decision when two thirds of confirmed chapter 13 plans already are not completed.

Sec. 607. Sense of the Congress regarding expansion of Rule 9011 of the Federal Rules of Bankruptcy Procedure.

Like H.R. 3150 as passed by the House of Representatives, section 607 expresses the sense of Congress that Rule 9011 should be modified to include a requirement that all documents, including schedules, should be submitted to a court or trustee only after the debtor or the debtor's attorney has made reasonable inquiry to verify that the information is well-grounded in fact and is warranted by existing law or a good faith argument for extension, modification, or reversal of existing law.

Page 241 PREV PAGE TOP OF DOC

COMMENTS: Independent verification of the information on the schedules may be impossible. The inability of lawyers to comply with this requirement may lead to a greater prevalence of bankruptcy petition preparers and pro se filings.

Sec. 608. Elimination of certain fees payable in chapter 11 bankruptcy cases.

Like H.R. 3150 as passed by the House of Representatives, this section amends 28 U.S.C. §1930(a)(6) to eliminate postconfirmation quarterly United States trustee fees when the quarterly disbursement is less than $300,000. This amendment would take effect on October 1, 1999.

COMMENTS: The National Bankruptcy Conference supports this amendment.

Sec. 609. Study of bankruptcy impact of credit extended to dependent students.

Section 609 directs the Comptroller General to undertake a study not later than 1 year after enactment of this bill to evaluate how the bankruptcy rate is affected by extensions of credit to postsecondary education students claimed as dependents.

COMMENTS: This provision is unobjectionable.

Sec. 610. Prompt relief from stay in individual cases.

Under section 610, if courts do not rule on motions for automatic stay relief within 60 days, the stay terminates automatically in the case of an individual debtor unless the parties agree to an extension of the deadline or the court orders an extension for "good cause."

Page 242 PREV PAGE TOP OF DOC

COMMENTS: Efforts to establish firm time limits for courts to issue rulings have not been effective in the past. Issues of timing should be handled by the Advisory Committee on Bankruptcy Rules of the Judicial Conference of the United States.

Sec. 611. Stopping abusive conversions from chapter 13.

Pursuant to this amendment to 11 U.S.C. §348, upon conversion from chapter 13 to chapter 7, claims are considered fully secured unless the claim already has been paid in full, notwithstanding any valuation or determination of the allowed secured claim in chapter 13. Prebankruptcy defaults not fully cured are given the same effect as under applicable nonbankruptcy law.

COMMENTS: This provision should include an additional amendment so that a debtor seeking to redeem property in a converted case may apply to the redemption price all chapter 13 plan payments and adequate protection payments. This may be accomplished by deleting subparagraph (C)(i) and by adding the following:

Section 722 of title 11, United States Code is amended by adding at the end—

In a case that has been converted under section 1307 of this title, the redemption price is the value of the collateral less any payments made under sections 1307A and 1326 of this title.

Page 243 PREV PAGE TOP OF DOC

TITLE VII.

Sec. 701. Improved bankruptcy statistics.

This section orders the clerk of each district to compile statistics in a format determined by the Administrative Office of the United States Courts, which will be collected by the Administrative Office and made publicly available and the subject of a report to Congress. The following information must be collected: total assets and liabilities, monthly income, projected income, average income and expenses, aggregate amount of debt discharged (using the following calculation: total debt minus "predominantly nondischargeable" debts), average case length, and reaffirmation information. For chapter 13 cases, the following must be collected: number of cases with property valued less than the amount of the claim (stripped down debts), number of cases dismissed for failure to pay in accordance with the plan, and number of cases with successive filings within six years after the first filing.

COMMENTS: Collecting data is advisable, but all language in this provision prescribing the method of collection and reporting should be deleted. The manner of collection and reporting should be developed by a balanced group of experts in the field of data collection and bankruptcy.

Sec. 702. Uniform rules for the collection of bankruptcy data.

This section instructs the Attorney General to issue rules requiring uniform forms for final trustee reports and periodic reports by debtors in possession and trustees in chapter 11 cases. Trustees' reports must include information regarding the following: length of time a case was pending, assets abandoned, assets exempted, receipts and disbursements of the estate, expenses of administration, claims asserted, claims allowed, distributions to claimants and claims discharged without payment. Chapter 11 reports must include information regarding standard industry classification, length of case, number of employees, cash receipts, disbursements, profitability, compliance with legal requirements, tax payments, professional fees, plans of reorganization filed, and recoveries of holders of each class of claims.

Page 244 PREV PAGE TOP OF DOC

COMMENTS: This provision is unobjectionable, subject to the same caveat as provided in the comments on section 701.

Sec. 703. Sense of the Congress regarding availability of bankruptcy data.

Section 703 expresses the sense of Congress that all data held by bankruptcy clerks should be released in electronic form to the public on demand and that the bankruptcy system should use a single set of data definitions and forms to collect data nationwide.

COMMENTS: Before taking steps to make this data widely available, Congress should evaluate whether laws such as the Fair Credit Reporting Act impose restrictions on this activity.

TITLE VIII.

Sec. 801. Treatment of certain liens.

This section exempts ad valorem real or personal property tax liens from subordination under 11 U.S.C. §724(b)(2), except that ad valorem tax liens would remain subordinated to priority wage claims. Although other tax liens remain subject to subordination, section 801 requires that a trustee first exhaust unencumbered assets of the estate and surcharge collateral under section 506(c) for the reasonably necessary costs and expenses of preserving and disposing of that property. Section 801 also amends 11 U.S.C. §505 to divest bankruptcy judges of their authority to determine the amount or legality of any ad valorem tax after expiration of the applicable period for contesting or redetermining that amount under nonbankruptcy law.

Page 245 PREV PAGE TOP OF DOC

COMMENTS: The National Bankruptcy Conference supports this provision to the extent that it exempts ad valorem tax liens from subordination under section 724(b). However, the remainder of the provision is objectionable. References to 11 U.S.C. §507(a) should be adjusted to reflect amendments in this bill that reorder the priorities set forth in that provision.

Sec. 802. Effective notice to government.

This section sets forth extensive parameters and details for providing notice to governmental units.

COMMENTS: The filing registry contemplated in proposed section 342(e) is unobjectionable, but the remainder of the provision should be deleted because it is unduly oppressive. Notice to government units is being addressed adequately in the revisions to the Federal Rules of Bankruptcy Procedure and should not be addressed in the statute. The United States government has requested to be treated as a single unit for other purposes, such as setoff. The government should not take noticing requirements to the other extreme by creating a complex bureaucracy that makes compliance extremely difficult even when the government has actual knowledge of the bankruptcy.

Sec. 803. Notice of request for a determination of taxes.

This section amends 11 U.S.C. §505(b) to require that any request for a determination of tax liability under that section be made in a manner designated by the governmental unit.

Page 246 PREV PAGE TOP OF DOC

COMMENTS: This provision would be unobjectionable if the information were published in a central registry to enable compliance. Absent a central registry, this provision is troublesome because it creates a new bureaucracy that unnecessarily makes compliance extremely difficult.

Sec. 804. Rate of interest on tax claims.

This provision establishes the rate of interest on most tax claims as the Federal short-term rate rounded to nearest full percent, determined under Internal Revenue Code section 1274(d) for the calendar year in which a plan is confirmed, plus 3 percentage points. The interest rate on ad valorem taxes is subject to determination under applicable nonbankruptcy law.

COMMENTS: This provision is objectionable and departs from its original intent to provide a uniform rate of interest. The interest rate on ad valorem taxes in some cities is well over 20%. Section 804 should be revised to provide that the rate of interest on all tax claims, including ad valorem tax claims, is the federal tax deficiency rate under 26 U.S.C. §6621(a)(2), as originally proposed by in the bankruptcy bill first introduced by Representative Gekas and his co-sponsors last year.

Sec. 805. Tolling of priority of tax claim time periods.

Section 805 authorizes the tolling of certain time periods in 11 U.S.C. §507(a)(8)(A). This provision also adds an extra 6 months to the tolling period under section 507(a)(8)(A)(i) and tolls the 240-day period under section 507(a)(8)(A)(ii) for the duration of an installment payment agreement, which could add years to the tolling period.

Page 247 PREV PAGE TOP OF DOC

COMMENTS: To the extent this provision tolls the priority and nondischargeability period for the duration of a prior bankruptcy case, this provision properly codifies current case law. However, the six month add-on and the tolling period for installment payment agreements give unwarranted benefits to taxing authorities to the detriment of other creditors and should be deleted.

Sec. 806. Priority property taxes incurred.

This provision amends 11 U.S.C. §507(a)(8)(B) by striking "assessed" and replacing it with "incurred."

COMMENTS: This provision may not have an appreciable effect and does not address the problems with the term assessment outside of the property tax context.

Sec. 807. Chapter 13 discharge of fraudulent and other taxes.

This section further restricts the scope of the chapter 13 "superdischarge" so that a debtor who has completed a repayment plan may not discharge remaining taxes falling under 11 U.S.C. §523(a)(1).

COMMENTS: This provision is controversial and may eliminate the incentive for debtors with substantial tax debts to repay some of those debts, along with other debts, in a chapter 13 plan. By increasing competition with support creditors, this provision undercuts the efficacy of other provisions attempting to ensure payment of those important obligations.

Page 248 PREV PAGE TOP OF DOC

Sec. 808. Chapter 11 discharge of fraudulent taxes.

Section 808 amends 11 U.S.C. §1141(d) so that chapter 11 plan confirmation does not discharge a *corporate* debtor (but not any other type of debtor) from tax debts on which the debtor made a fraudulent return or which the debtor willfully attempted to evade or defeat.

COMMENTS: The National Bankruptcy Conference urges deletion of this section. The reorganized debtor is a separate entity for other tax purposes and should not be liable for these obligations. Most chapter 11 corporate debtors are insolvent and often controlling ownership is transferred to creditors under a plan of reorganization. It is inappropriate to punish creditors for failures of prior ownership or management.

Sec. 809. Stay of tax proceedings.

This section provides an exception to the automatic stay for appeals from certain court and administrative decisions determining a tax liability of the debtor.

COMMENTS: The scope of this provision is not quite clear. The proposed automatic stay exception is one of many in this bill, which in aggregate may erode the protection of estate assets.

Sec. 810. Periodic payment of taxes in chapter 11 cases.

Page 249 PREV PAGE TOP OF DOC

This section requires periodic payment of priority tax claims in regular installment payments in cash, "but in no case with a balloon provision and no more than three months apart, beginning no later than the effective date of the plan and ending on the earlier of five years after the petition date or that last date payments are to be made under the plan to unsecured creditors." In addition, the petition date, not the assessment date, is the starting point for the payment period.

COMMENTS: This provision should be deleted. Prior to the Bankruptcy Reform Act of 1978, taxing authorities exercised virtual veto power over plans of reorganization. The 1978 Code was a compromise to make reasonable accommodations for rehabilitation. If enacted, this provision may require that other creditors, such as support creditors in the chapter 11 case of an individual debtor, wait years for repayment.

If retained, the provision should be redrafted to correct its problems. The provision should clarify that "regular payments" do not have to be equal. According to the plain language of the provision, tax debts may not be deferred at all if other unsecured creditors are paid in full at confirmation, which is unrealistic and should be fixed.

Sec. 811. Avoidance of statutory tax liens prohibited.

Section 811 amends 11 U.S.C. §545(2) to codify that "superpriority" rights accorded to some purchasers by the Internal Revenue Code and parallel state and local law provisions may not be used by a trustee to avoid tax liens in stocks, securities, motor vehicles, inventory, certain goods purchased at retail, and certain household goods.

Page 250 PREV PAGE TOP OF DOC

COMMENTS: There are preferable methods of clarifying the reach of a bona fide purchaser. Section 545(2) should be clarified to give the trustee the status of a hypothetical bona fide purchaser without knowledge or notice of a lien, who takes possession of the item purchased and has not relinquished possession. This status would preserve for the benefit of all creditors those items of property on which the filed tax lien does not take priority in all circumstances under nonbankruptcy law. A similar change should be made to the definition of purchaser in section 544(a). Statutory language will be provided on request.

Sec. 812. Payment of taxes in the conduct of business.

This section requires that postpetition taxes be paid in the ordinary course of business, that ad valorem real property taxes be paid when due, and that administrative period tax liabilities be paid without a precipitating request from the governmental unit. This section also amends 11 U.S.C. §506 to permit ad valorem taxes to be surcharged against collateral. This section permits deferred tax payments in the event that a chapter 7 estate is administratively insolvent or that a tax was not incurred by a properly appointed chapter 7 trustee.

COMMENTS: It is reasonable to require that an operating chapter 11 debtor pay taxes in the normal course as a business expense, which is why 28 U.S.C. §960 already provides that any officers and agents conducting business under authority of a United States court shall be subject to all taxes applicable to such business to the same extent as if it were conducted by an individual or corporation. The chapter 7 exception also is reasonable.

Page 251 PREV PAGE TOP OF DOC

Sec. 813. Tardily filed priority tax claims.

This section amends 11 U.S.C. §726(a)(1) so that late filed tax claims are entitled to distribution under that subsection to the extent they are filed on or before the earlier of 10 days following the mailing to creditors of the trustee's report summary, or the date on which the trustee commences distribution.

COMMENTS: The National Bankruptcy Conference supports this provision.

Sec. 814. Income tax returns prepared by tax authorities.

Under this section, for purposes of 11 U.S.C. §523(a)(1)(B), "return" includes returns filed by the governmental unit or a written stipulation to judgment entered by a nonbankruptcy tribunal.

COMMENTS: The intent of this provision is unobjectionable. However, it is unclear why the amendment also provides that the return must have been filed in a manner permitted by applicable nonbankruptcy law, which may cause confusion and is not necessary to effectuate the primary component of this section.

Sec. 815. Discharge of the estate's liability for unpaid taxes.

This provision adds the bankruptcy estate to the list of parties protected from a tax claim once a governmental unit fails to respond to a request for a determination of taxes under 11 U.S.C. §505(b).

Page 252 PREV PAGE TOP OF DOC

COMMENTS: The National Bankruptcy Conference supports this provision.

Sec. 816. Requirement to file tax returns to confirm chapter 13 plans.

Section 816 requires that debtors file tax returns for the three years before bankruptcy prior to the first meeting of creditors. The section makes some allowance for extensions of the applicable deadlines.

COMMENTS: Although some wage earners may comply easily with this provision, others may have more difficulty, particularly if they have held multiple jobs or have had independent contractor status. This provision also might prolong the chapter 13 process. If this provision is enacted, the standard for extensions of time should be based on the preponderance of the evidence, not clear and convincing evidence. In addition, the provision should be revised to ensure that it is not construed to require that tax returns be filed by debtors who need not file returns under tax law.

Sec. 817. Standards for tax disclosure.

This section amends 11 U.S.C. §1125 to require that disclosure statements contain a "full discussion" of the tax consequences of a plan of reorganization.

COMMENTS: To the extent that the disclosure of tax consequences is necessary to provide adequate information, this provision is unnecessary because adequate information already is required by 11 U.S.C. §1125. Tax consequences unnecessary to provide adequate information and irrelevant to creditors and interest holders should not be required. Mandating the disclosure of unnecessary information increases cost and delay in the plan confirmation process, contrary to the goal of expediting chapter 11. If this provision is retained, the term ''a full discussion'' should be replaced with ''adequate information regarding''.

Page 253 PREV PAGE TOP OF DOC

Sec. 818. Setoff of tax refunds.

Section 818 amends 11 U.S.C. §362 to permit the government to set off uncontested prepetition income tax obligations against prepetition income tax refund rights without seeking court permission.

COMMENTS: The National Bankruptcy Conference opposes this provision. Absent setoff, the tax refund would be cash collateral subject to turnover and use by the estate. As long as the debtor in possession provides the taxing authority with adequate protection, this source of liquidity should remain available.

TITLE IX.

Sec. 901. Amendment to add chapter 15 to title 11, United States Code.

This section creates a chapter 15 of the Bankruptcy Code to deal with ancillary and other cross-border cases.

COMMENTS: The National Bankruptcy Conference supports the establishment of a chapter to deal with ancillary and other cross border cases to the extent consistent with the statutory language developed by the United Nations Commission on International Trade Law.

Sec. 902. Amendments to other chapters in title 11, United States Code.

Page 254 PREV PAGE TOP OF DOC

This section amends other provisions of the Bankruptcy Code to reflect the addition of chapter 15.

COMMENTS: The National Bankruptcy Conference supports the adoption of conforming amendments to the extent consistent with the statutory language developed by the United Nations Commission on International Trade Law.

TITLE X.

Sec. 1001. Treatment of certain agreements by conservators or receivers of insured depository institutions; Sec. 1002. Authority of the corporation with respect to failed and failing institutions; Sec. 1003. Amendments relating to transfers of qualified financial contracts; Sec. 1004. Amendments relating to disaffirmance or repudiation of qualified financial contracts; Sec. 1005. Clarifying amendment relating to master agreements; Sec. 1006. Federal deposit insurance corporation improvement act of 1991.

These provisions make amendments to the Federal Deposit Insurance Act regarding the definitions and treatment of various financial contracts.

COMMENTS: The National Bankruptcy Conference does not have comments on these provisions.

Sec. 1007. Bankruptcy code amendments.

Page 255 PREV PAGE TOP OF DOC

(a) *Definitions of forward contract, repurchase agreement, securities clearing agency, swap agreement, commodity contract, and securities contract*.

This subsection provides revised definitions of the above listed contracts and parties.

COMMENTS: These definitions are unobjectionable to the extent they are narrowly tailored to exclude transactions such as secured loans.

(b) *Definitions of financial institution, financial participant, and forward contract merchant.*

This subsection revises the definitions of financial institution and forward contract merchant and provides a definition of financial participant.

COMMENTS: These definitions are unobjectionable.

(c) *Definition of master netting agreement and master netting agreement participant.*

Subsection (c) amends 11 U.S.C. §101 to add broad definitions of master netting agreement and master netting agreement participant. The definition of master netting agreement encompasses rights of netting, setoff, liquidation, termination, or closeout not only with a variety of financial instruments, but with security agreements and credit enhancement as well.

Page 256 PREV PAGE TOP OF DOC

COMMENTS: This provision is unobjectionable to the extent it protects single product netting and is objectionable to the extent it permits and expands cross product netting.

(d) *Swap agreements, securities contracts, commodity contracts, forward contracts, repurchase agreements, and master netting agreements under the automatic stay.*

This subsection revises the exceptions to the automatic stay for setoff by financial participants of claims against payments due, and adds an additional exception to section 362(b) to permit cross product netting without violating the automatic stay.

COMMENTS: This provision is objectionable to the extent that it permits cross product netting and overrides the equitable powers of the bankruptcy court under 11 U.S.C. §105(a). Under appropriate circumstances, the court should retain the power to provide injunctive relief.

(e) *Limitation of avoidance powers under master netting agreement.*

This subsection amends 11 U.S.C. §546 to preclude a trustee from avoiding a transfer made by or to a master netting agreement participant under or in connection with any master netting agreement, except if the transfer was made with the actual intent to hinder, delay, or defraud.

Page 257 PREV PAGE TOP OF DOC

COMMENTS: This provision is objectionable to the extent that it limits the ability of a trustee or debtor in possession to recover cross product netting transfers under the avoiding powers.

(f) *Fraudulent transfers of master netting agreements.*

This subsection would amend 11 U.S.C. §548(d)(2) to insulate certain transfers to master netting agreement participants.

COMMENTS: This provision is objectionable to the extent that it insulates cross product netting from fraudulent transfer avoidance actions.

(g) *Termination or acceleration of securities contracts.*

(h) *Termination or acceleration of commodities or forward contracts*

(i) *Termination or acceleration of repurchase agreements.*

In the aforementioned three subsections, 11 U.S.C. §555, 556, and 559 are amended to refer to termination and acceleration in addition to liquidation.

COMMENTS: These provisions are unobjectionable.

Page 258 PREV PAGE TOP OF DOC

(j) *Liquidation, termination, or acceleration of swap agreements.*

Subsection (j) amends 11 U.S.C. §560 to add a reference to liquidation and acceleration, in addition to termination.

COMMENTS: This amendment is unobjectionable.

(k) *Liquidation, termination, acceleration, or offset under a master netting agreement and across contracts.*

This subsection adds 11 U.S.C. §561, which prohibits the application of the stay, avoidance, or any other limitations on a contractual right to terminate, liquidate, accelerate, or offset under a master netting agreement and across contracts.

COMMENTS: This provision is objectionable to the extent it exempts cross product netting from the avoidance powers, the automatic stay, and other otherwise applicable provisions.

(l) *Municipal bankruptcies.*

This subsection applies the securities contract liquidation provisions to chapter 9 municipal bankruptcy cases.

COMMENTS: The National Bankruptcy Conference supports this provision.

Page 259 PREV PAGE TOP OF DOC

(m) *Ancillary proceedings.*

Pursuant to this subsection, cases ancillary to foreign proceedings are subject to all Bankruptcy Code provisions relating to securities contracts, commodity agreements, forward contracts, repurchase agreements, swap agreements, or master netting agreements.

COMMENTS: This provision should be coordinated with proposed chapter 15 and the proposed revision to 11 U.S.C. §304.

(n) *Commodity broker liquidations.*

(o) *Stockbroker liquidations.*

These two subsections add 11 U.S.C. §767 and 753 to address the liquidation of commodity brokers and stockbrokers. Under these provisions, the exercise of rights by a broker or participant would not affect the priority of unsecured claims held by brokers or participants after the exercise of their rights or the applicability of the commodity broker and stockbroker liquidation provisions.

COMMENTS: These provisions are unobjectionable.

(p) *Setoff.*

This subsection makes conforming amendments to 11 U.S.C. §553 to reflect the exceptions to the general rules of setoff provided for financial instruments. It creates a carveout to the exception to the right to setoff in section 553(a)(3)(C) for rights arising under provisions dealing with financial contracts. This subsection also amends 553(b)(1) to add additional references to these provisions.

Page 260 PREV PAGE TOP OF DOC

COMMENTS: This provision is unobjectionable.

(q) *Securities contracts, commodity contracts, and forward contracts.*

This subsection clarifies the language in several Bankruptcy Code provisions by replacing references to a variety of parties with the term "financial participant."

COMMENTS: This provision is unobjectionable.

Sec. 1008. Recordkeeping requirements.

This section amends the Federal Deposit Insurance Act to authorize the FDIC to prescribe regulations that require detailed recordkeeping by insured depository institutions with respect to qualified financial contracts.

COMMENTS: The National Bankruptcy Conference does not have comments on this provision.

Sec. 1009. Exemptions from contemporaneous execution requirement.

This provision amends the Federal Deposit Insurance Act section 13(e)(2) to provide that an agreement to provide for the lawful collateralization of bankruptcy estate funds pursuant to 11 U.S.C. §345(b)(2) and other agreements is not invalid solely because the agreement was not executed contemporaneously with the acquisition of collateral or because of pledges, delivery, or substitution of collateral made in accordance with such agreement.

Page 261 PREV PAGE TOP OF DOC

COMMENTS: This provision is unobjectionable.

Sec. 1010. Damage measure.

This section addresses the calculation of damages following the rejection, liquidation, termination, or acceleration of certain agreements relating to financial instruments. It provides that damages shall be measured as of the earlier of the date of rejection or the date of liquidation, termination or acceleration. The resulting damage claim is treated as a prepetition claim, consistent with other claims arising from rejection.

COMMENTS: This provision is unobjectionable.

Sec. 1011. SIPC stay.

This provision adds a new paragraph to section 5(b)(2) of the Securities Investor Protection Act of 1970 which states that nothing in the Bankruptcy Code stays the contractual rights of a creditor to liquidate, terminate, or accelerate a securities contract, but that a court order may operate as a stay of the foreclosure on securities collateral pledged by the debtor.

COMMENTS: This provision is unobjectionable.

Sec. 1012. Asset-backed securitizations.

Page 262 PREV PAGE TOP OF DOC

This section explicitly excludes from "property of the estate" cash, receivables, securities, and other financial assets transferred by the debtor in connection with an asset securitization under which investment grade rated securities have been issued. The debtor is considered to have transferred assets prepetition if the assets were transferred pursuant to a written agreement that states that the assets were conveyed with the intention of removing them from the estate of the debtor, regardless of whether the debtor holds an interest in the issuer or securities held by the issuer, whether the debtor has continuing obligations to repurchase, service, or supervise the servicing of eligible assets, and the characterization of the transfer for other purposes.

COMMENTS: The National Bankruptcy Conference opposes this provision, which inappropriately permits rating agencies and private parties to make the legal determination of whether an asset is property of a bankruptcy estate. Transactions that are not sales under state law should not be treated as sales by federal bankruptcy law to the detriment of the estate and unsecured creditors. This provision may undercut the ability of a business to reorganize by leaving it with no cash collateral, to the detriment of employees and suppliers.

Sec. 1013. Federal reserve collateral requirements.

This section changes the statutory references in section 16 of the Federal Reserve Act.

COMMENTS: The National Bankruptcy Conference does not have comments on this provision.

Page 263 PREV PAGE TOP OF DOC

Sec. 1014. Severability; effective date; application of amendments.

This section provides that these amendments (presumably Title X, but the provision does not say so explicitly), remain in effect if provisions are found to be unconstitutional. The Act takes effect on the date of enactment, and the amendments made by the Act apply to cases commenced or appointments made after the date of enactment.

COMMENTS: This provision is unobjectionable, but should say explicitly that it applies only to Title X of this bill.

TITLE XI.

Sec. 1101. Definitions.

This section amends the definition of single asset real estate to lift the $4 million debt cap and to exclude family farmers. This section also redefines transfer to clarify that a transfer includes the creation of a lien, addressing issues raised in the line of cases culminating in In re McConville, 110 F.3d 47 (9th Cir. 1997).

COMMENTS: The National Bankruptcy Conference opposes the lifting of the single asset real estate cap and recommends that the cap be raised from $4 to $15 million. The National Bankruptcy Conference supports the statutory clarification that a transfer of property includes the creation of a lien. The word ''each'' should be deleted and replaced with ''every'' in proposed 11 U.S.C. §101(54)(D).

Page 264 PREV PAGE TOP OF DOC

Sec. 1102. Adjustment of dollar amounts.

This section ensures that the dollar amounts in section 522(f)(3) (lien on tools of the trade exceeding $5,000 cannot be avoided) and the proposed section 707(b)(5) (safe harbor against creditor actions) are indexed for inflation.

COMMENTS: This provision is unobjectionable, although it does not address all problems created by section 522(f).

Sec. 1103. Extension of time.

This section corrects a reference error.

COMMENTS: This provision is unobjectionable.

Sec. 1104. Technical amendments.

This section pluralizes a reference in 11 U.S.C. §522(b)(1), makes a technical change to 11 U.S.C. §541(b)(4), and slightly broadens the reference to a subsection of the Small Business Investment Act of 1958, which likely has the effect of making more debtors ineligible to file.

COMMENTS: This provision is unobjectionable.

Sec. 1105. Penalty for persons who negligently or fraudulently prepare bankruptcy petitions.

Page 265 PREV PAGE TOP OF DOC

This section makes a grammatical change, changing the reference to "attorney's" in section 110(j)(3) from singular possessive to plural possessive.

COMMENTS: This provision is unobjectionable. Although pluralization amendments may be unnecessary because references to the singular include the plural, see 11 U.S.C. §102(7), legislative counsel should make all title 11 references to this term consistent.

Sec. 1106. Limitation on compensation of professional persons.

Section 1106 amends 11 U.S.C. §328(a) to provide that a trustee or committee may employ professional persons on a fixed or percentage fee basis.

COMMENTS: This provision is unobjectionable.

Sec. 1107. Special tax provisions.

This amendment eliminates a reference to a tax provision that has been repealed.

COMMENTS: This provision is unobjectionable.

Sec. 1108. Effect of conversion.

This section changes a reference to "property" in 11 U.S.C. §348(f)(2) to "property of the estate" to conform to other references in that provision.

Page 266 PREV PAGE TOP OF DOC

COMMENTS: This provision is unobjectionable.

Sec. 1109. Amendment to table of sections.

This section corrects the table of sections to reflect the proper section heading for section 556.

COMMENTS: This provision is unobjectionable.

Sec. 1110. Allowance of administrative expenses.

This section limits the types of compensable professional services rendered by an attorney or accountant that may qualify as administrative expenses. In particular, expenses for attorneys or accountants incurred by individual members of creditors' or equity committees are not recoverable as administrative expenses.

COMMENTS: This provision is unobjectionable.

Sec. 1111. Priorities.

This provision makes punctuation changes to 11 U.S.C. §507 and changes "allowed claim" to "allowed unsecured claim" in section 507(a)(7).

COMMENTS: This provision is unobjectionable but this technical amendment does not reflect the renumbering of the paragraphs in section 507(a) by section 142 of this bill.

Page 267 PREV PAGE TOP OF DOC

Sec. 1112. Exemptions.

This section makes slight grammatical changes to 11 U.S.C. §522(f) and (g).

COMMENTS: This provision is unobjectionable.

Sec. 1113. Exceptions to discharge.

This section corrects the inadvertent omission of a reference to section 523(a)(15) in section 523(a)(3). Section 523(a)(15) is amended to limit the scope of the exception by requiring that the debt must be owed to a spouse, former spouse, or child of the debtor. This section also amends section 523(a)(9) to specifically exclude from discharge debts arising from drunken boating.

COMMENTS: The expansion of section 523(a)(9) addresses a matter better addressed by state law and duplicates one of the amendments made in section 131 of this bill.

Sec. 1114. Effect of discharge.

This section makes technical corrections to 11 U.S.C. §524(a)(3).

COMMENTS: This provision does not appear to change the existing text of section 524(a)(3).

Page 268 PREV PAGE TOP OF DOC

Sec. 1115. Protection against discriminatory treatment.

Under this provision, 11 U.S.C. §525(c) is amended to clarify section 525(c)(1) applies to student grants, not all grants.

COMMENTS: This provision is unobjectionable.

Sec. 1116. Property of the estate.

This section amends section 541(b)(4)(B)(ii) (dealing with liquid or gaseous hydrocarbons) to add a reference to 11 U.S.C. §365, to clarify Congressional intent to exclude production payments from the debtor's estate.

COMMENTS: This provision is unobjectionable.

Sec. 1117. Preferences.

This section amends 11 U.S.C. §547(b) so that in the event of an avoided security interest given by a debtor between 90 days and 1 year before bankruptcy to a noninsider for the benefit of an insider, the security interest shall be considered to be avoided as a preference only with respect to the insider.

COMMENTS: This amendment is unobjectionable but could be improved by referring to transfers rather than security interests. In particular, ''security interest given'' should be replaced with ''transfers made'' and ''such security interest shall be considered to'' should be replaced with ''such transfer may be avoided.''

Page 269 PREV PAGE TOP OF DOC

Sec. 1118. Postpetition transactions.

This section makes several clarifying changes to 11 U.S.C. §549(c) to work in conjunction with the change to the definition of transfer, discussed above.

COMMENTS: The National Bankruptcy Conference supports this provision.

Sec. 1119. Disposition of property of the estate.

This section eliminates a reference to 11 U.S.C. §1009, a provision in an earlier version of the 1994 amendments that never came into effect.

COMMENTS: This provision is unobjectionable.

Sec. 1120. General provisions.

This provision amends 11 U.S.C. §901(a) to add an omitted reference to 11 U.S.C. §1123(d).

COMMENTS: This provision is unobjectionable.

Sec. 1121. Appointment of elected trustee.

Page 270 PREV PAGE TOP OF DOC

This section clarifies the procedure for the election of a private trustee in a chapter 11 case. The United States trustee must file a report certifying the election, which terminates the service of a previously-appointed trustee. Courts are authorized to resolve disputes arising out of an election.

COMMENTS: The National Bankruptcy Conference supports this provision, but recommends that proposed section 1104(b)(2)(B) be revised to read as follows: ''The court shall resolve any dispute arising out of an election under subparagraph (A).''

Sec. 1122. Abandonment of railroad line.

This section amends 11 U.S.C. §1170(e)(1) to eliminate a reference to a repealed provision in Title 49 and to replace it with a correct reference.

COMMENTS: This provision is unobjectionable.

Sec. 1123. Contents of plan.

This section amends 11 U.S.C. §1172(c)(1) to eliminate a reference to a repealed provision in Title 49 and to replace it with a correct reference.

COMMENTS: This provision is unobjectionable.

Sec. 1124. Discharge under chapter 12.

Page 271 PREV PAGE TOP OF DOC

Section 1124 corrects erroneous references in 11 U.S.C. §1228(a) and (c).

COMMENTS: This provision is unobjectionable.

Sec. 1125. Bankruptcy cases and proceedings.

This section corrects erroneous references in 28 U.S.C. §1334(d).

COMMENTS: This provision is unobjectionable.

Sec. 1126. Knowing disregard of bankruptcy law or rule.

This section amends 18 U.S.C. §156(a) to make stylistic changes and to clarify a reference to Title 11.

COMMENTS: This provision is unobjectionable.

Sec. 1127. Transfers made by nonprofit charitable corporations.

This section amends 11 U.S.C. §363 and 1129(a) to require that all transfers of property in the bankruptcy case of a corporation or trust (that is not a moneyed, business, or commercial corporation or trust) are in complete accordance with all laws governing the transfer of property. This section also amends 11 U.S.C. §541 to provide that property held by a corporation exempt from taxation under 26 U.S.C.§501(c)(3) may be transferred to an entity that is not such a corporation, but only under the same conditions as would apply had the debtor not filed a bankruptcy case. These amendments, if adopted, would apply to pending cases. However, a court would consider whether the application of these amendments to pending cases would substantially affect the rights of a party in interest who first acquired rights with respect to the debtor postpetition.

Page 272 PREV PAGE TOP OF DOC

COMMENTS: The National Bankruptcy Conference opposes these amendments, which will be relevant to cases involving hospitals and other nonprofit organizations. By negative implication, these amendments might suggest that other types of debtors do not need to follow otherwise applicable nonbankruptcy law. Subsection (e), which clarifies that the bankruptcy court need not remand or refer the matter of a transfer of property to a nonbankruptcy court, creates an ambiguity regarding the jurisdiction of the bankruptcy court and state court in the sale of the assets of a not for profit debtor. The provision is also ambiguous when it requires that the court consider whether these amendments ''would substantially affect the rights of a party in interest who first acquired rights with respect to the debtor'' postpetition.

If this provision is adopted, the following technical comments should be considered. References to ''corporation or trust'' are superfluous because the definition of corporation includes trust. See 11 U.S.C. §101(9). Paragraph (1) of section 363(d) should begin with the following clause: ''if the debtor is a corporation that is not a moneyed, business, or commercial corporation,''. Similarly, paragraph (15) of section 1129(a) should begin with the same clause and the phrase ''of the plan'' should be deleted and replaced with ''under the plan''. The amendment made by subsection (c) of section 1127 of this bill should be made to 11 U.S.C. §363 (as new subsection (p)), not to 11 U.S.C. §541. The latter portion of subsection (d) of the amendment, which begins with ''The parties who may appear,'' should be a statutory amendment that should read as follows:

(e) Standing.—Section 1109 of title 11, United States Code, is amended by adding at the end:

Page 273 PREV PAGE TOP OF DOC

''(c)The attorney general of the State in which the debtor is incorporated, was formed, or does business may appear and be heard in any proceeding under section 363(p) or 1129(a)(15) of this title.''

Sec. 1128. Prohibition on certain actions for failure to incur finance charges.

Section 1128 amends section 127 of the Truth and Lending Act to prevent a creditor from terminating a credit card account prior to its expiration solely because a customer has not incurred finance charges on the account.

COMMENTS: This amendment is far less effective than section 405 of H.R. 3150 as passed by the Senate, which received overwhelming support in both the House and the Senate and would have amended the Truth in Lending Act. The Senate version prohibits creditors from refusing to renew, continuing to offer credit, or charging a fee solely because a consumer has not incurred finance charges in connection with an extension of credit.

Sec. 1129. Protection of valid purchase money security interests.

This section amends 11 U.S.C. 547(c)(3)(B), give a creditor 30 days, rather than 20 days, to perfect its interest for an enabling loan.

COMMENTS: The perfection period was just increased from 10 to 20 days in the Bankruptcy Reform Act of 1994. The period should not be further extended without a demonstration that the longer period is necessary. If this provision is retained, it should permit the lesser of the time allowed by state law or 30 days.

Page 274 PREV PAGE TOP OF DOC

Sec. 1130. Trustees.

This provision generally incorporates the provisions of the Private Trustee Reform Act of 1997, H.R. 2792, which authorizes district court judicial review of U.S. trustee decisions to remove trustees from the panel or to stop assigning cases to a particular private trustee or to resolve disputes over trustee expenses. Trustees first must exhaust administrative remedies before seeking federal court review. The failure of the agency to act within 90 days satisfies the exhaustion requirement. Trustees then may commence an action in the district court. The legislation also offers a standard of review for the district court: the district court shall affirm the agency decision unless it is "unreasonable and without cause based on the administrative record before the agency."

COMMENTS: This amendment has been improved by the elimination of explicit reference to bankruptcy judges.

TITLE XII.

Sec. 1201. Effective date; application of amendments.

Except as otherwise provided in this Act (*e.g.*, sections 608, 1014, 1127), the Act and its amendments take effect 180 days after the date of enactment. The amendments made by the Act do not apply to cases commenced before the effective date.

COMMENTS: Like the Bankruptcy Reform Act of 1978, the effective date of this bill should be deferred for one year.

Page 275 PREV PAGE TOP OF DOC

Mr. **GEKAS.** And we now turn to Mr. Tassey.

STATEMENT OF JEFFREY A. TASSEY, SENIOR VICE PRESIDENT OF GOVERNMENTAL AND LEGAL AFFAIRS, AMERICAN FINANCIAL SERVICES ASSOCIATION, WASHINGTON, DC

Mr. **TASSEY.** Thank you, Mr. Chairman.

Mr. Chairman, members of the subcommittee, my name is Jeff Tassey; and I am presenting this testimony on behalf of the American Financial Services Association, AFSA. Our members include major providers of all types of secured and unsecured credit, and we appreciate this opportunity to express our views.

The appropriate role for the Bankruptcy Code, in our view, is to deal with failures that occur on all sides of the debtor/creditor relationship without unfairly harming any of the participants.

Debtors that can't pay should be processed through the system as quickly as possible. Those who can pay a meaningful amount of the debt that they voluntarily contracted to take on should do so. Debtors should receive the relief they need, and the bankruptcy system should provide essential fairness, uniformity, certainty and predictability to all parties and to society as a whole.

H.R. 833, by and large, promotes these objectives, and we urge the subcommittee to move forward with the bill.

Page 276 PREV PAGE TOP OF DOC

Opponents of H.R. 833 claim that the industry is responsible for the problem of bankruptcy by indiscriminately extending too much credit in the form of credit cards. Nothing is further from the truth on both a statistical and qualitative basis.

First of all, if bankruptcy were simply a matter of too much credit, bankruptcy rates would be uniform across the country. In fact, they are not. They show wild variations across the Nation and within the individual States. For example, Shelby County, Tennessee, has a bankruptcy rate that is roughly 32 times the national average. Does Shelby

County get 32 times the amount of credit that the rest of the country does? No, of course not.

Well, then if not too much credit, what does cause bankruptcy?

The causes are very complex, and frequently a number of factors are present. Some of the main causes of correlations include divorce, lack of health insurance, lack of mandatory automobile insurance laws and so on. Unemployment in and of itself is not a big factor. Urban areas have the highest bankruptcy rates. They also have the highest divorce rates. Young adults between the ages of 21 and 25 have low rates of bankruptcy files, as do adults over the age 41.

The age group most likely to file are those in the early 30's, particularly age 32. Poor people and minorities have relatively low rates of filings, while filings take off as you approach a total annual income of between $32,000 and $36,000 and remain high thereafter.

Page 277 PREV PAGE TOP OF DOC

There is no way to screen for most of these types of events and characteristics during the underwriting process, and it is probably undesirable. Should we not lend to 32-year-olds? Should we ask applicants if they are happily married?

What about credit cards? Credit cards of all types account for about 9 percent of all debt. Is this 9 percent of consumer debt causing all of the problems while the other 91 percent maintains a benign budgetary impact? This is counterintuitive, as all of us know. Our big obligations are housing, car, student loans, and so forth.

Do credit cards play any role in bankruptcy? Of course, they do, but they are no way the principal cause. In general, the role that credit cards play is that they are the last form of credit available for use before filing for bankruptcy. When a debtor gets into financial trouble, for whatever reason, they will frequently try to float themselves using their credit cards. Or if a debtor is planning to file a bankruptcy of convenience, they will frequently use their credit cards to acquire certain goods or make certain payments prior to filing.

The industry has learned to identify some of this behavior and can sometimes reduce losses, but particularly in the case of planned or noninsolvent bankruptcies it is virtually impossible to do so.

Just to conclude, Mr. Chairman, where a debtor has no meaningful ability to repay their debts and we don't feel that there is anything in this bill that forces people who can't pay to pay, they receive protection under H.R. 833. Where a debtor has a meaningful ability to repay, then there must be some effort to do so. That is the kind of bankruptcy system that Americans want. And we again urge the subcommittee to move forward.

Page 278 PREV PAGE TOP OF DOC

Thank you.

Mr. **BRYANT.** [Presiding.] Thank you, Mr. Tassey.

[The prepared statement of Mr. Tassey follows:]

PREPARED STATEMENT OF JEFFREY A. TASSEY, SENIOR VICE PRESIDENT OF GOVERNMENTAL AND LEGAL AFFAIRS, AMERICAN FINANCIAL SERVICES ASSOCIATION, WASHINGTON, DC

The American Financial Services Association (AFSA) appreciates this opportunity to express our views on H.R. 833, the "Bankruptcy Reform Act of 1998". AFSA is the trade association for a wide variety of non-traditional, market-funded providers of financial services to consumers and small businesses. AFSA members include major providers of secured and unsecured credit.

We look forward to working with the Subcommittee to pass H.R. 833 and to achieve a bankruptcy system that protects responsible borrowers through the provision of an appropriate needs based mechanism ensuring that those who can clearly repay a significant portion of their debts, do so. Before directly addressing some of the secured provisions in the bill, AFSA would like to comment on some of the issues that have continually come up when needs based bankruptcy reform is discussed.

SUMMARY OF AFSA'S POSITION

Page 279 PREV PAGE TOP OF DOC

Overview of H.R. 833

H.R. 833 is the exact text of the conference report on H.R. 3150 that was passed 300–125 by the House on October 9, 1998, during the final days of the 105th Congress. The bill represents a substantial compromise from the original House-passed version of H.R. 3150.(see footnote 15) Nonetheless, while weakened from the original, H.R. 833 remains a balanced, comprehensive approach. H.R. 833 substantially restores the principles of fairness and personal responsibility to our bankruptcy system, while protecting, and in some places enhancing, the rights of the consumer. The heart of this legislation is a needs-based formula that would direct filers into Chapter 7 or Chapter 13 based on their ability to pay. The formula would move into Chapter 13 those filers who earn more than the national median income (roughly $51,000 for a family of four) and who can ultimately pay all secured debt and at least 25 percent of unsecured non-priority debt. Additionally, the legislation recognizes that creditors should take on additional responsibilities, and proposes new disclosures and other educational provisions. Key provisions of the bill are summarized below.

SUMMARY OF KEY PROVISIONS IN H.R. 833

Needs-Based Bankruptcy

H.R. 833 creates a fair, needs-based system that takes debtors' special circumstances into account while assuring that those who can afford to pay are required to do so. The legislation creates a presumption that a Chapter 7 proceeding should be dismissed or converted to Chapter 13 if the filer earns more than the national median income and can afford to pay back either $5,000 or 25 percent of his or her unsecured, non-priority debt over five years. The judge can then take any extraordinary circumstances into account, such as a decline in income or an unexpected medical expense, before making a decision to shift the debtor into Chapter 13 or dismiss the case. In certain cases where the debtor is subsequently moved into Chapter 13, and the debtor's attorney's actions in filing the case are not substantially justified, the attorney may be required to pay for all costs associated with challenging the "abusive" filing.

Page 280 PREV PAGE TOP OF DOC

For a Chapter 7 debtor whose income exceeds the national median, H.R. 833 also allows other interested parties, such as banks or creditors, to bring a motion to shift the debtor into Chapter 13 based on the debtor's ability to repay. If the third party, however, can be shown to have brought motion without substantial justification, the third party may be required to pay the debtor's attorney fees.

The bill also includes new requirements to facilitate the administration of the needs-based system. Debtors, for example, will be required to include needs-based calculations in their statement of income and expenses, providing an easy "first-look" enforcement tool. The trustee or administrator must review the debtor's schedules and file a report at least 10 days before the first meeting of creditors as to whether the debtor's case is presumed to be one that should be dismissed. Each creditor is to receive that statement within five days.

Prioritizing Family Support Obligations

H.R. 833 recognizes that no obligation is more important than that of a parent to his or her children. A number of provisions designed to strengthen protections for child support and alimony payments are contained in the bill. For instance, the obligation to pay these vital family support obligations becomes the top priority when determining which debts are paid first in a bankruptcy case. This represents a substantial change from current law, in which child support and alimony payments are the seventh priority, behind such things as attorney's fees.

Additionally, the bill makes both confirmation and discharge of Chapter 13 plans conditional upon the debtor's complete payment of child support and alimony obligations. Among other things, H.R. 833 provides that the automatic stay does not apply to a state child support collection agency that seeks to impose or enforce a wage order for these obligations.

Page 281 PREV PAGE TOP OF DOC

New Creditor Responsibilities

Credit Card Disclosures: H.R. 833 requires creditors to send information, both at the time a customer opens an account, and again annually thereafter, about incurring interest expense and the costs of paying only the minimum required amount. A worksheet must also be sent to credit card customers annually to help them understand their current credit and expense obligations and the impact of taking on more debt. Additionally, all credit card statements must explain that paying only the minimum will cost more over time.

Federal Reserve Board Study of Creditor Practices: H.R. 833 requires the Federal Reserve Board to study whether consumers have adequate information about borrowing activities which may result in financial problems, including information related to minimum payments. This study would also consider the impact that the availability of minimum payment options has on consumers experiencing financial difficulty. The Board is authorized to issue regulations requiring additional disclosures as necessary.

Study of Students and Credit Cards: H.R. 833 directs the General Accounting Office to study the impact that extending credit to college students has on the rate of bankruptcy cases filed. This study shall be presented to Congress within one year following enactment of the Act.

Convenience Users Restrictions: H.R. 833 amends the Truth in Lending Act to provide that an open-end creditor cannot terminate an account prior to its expiration date solely because the consumer has not incurred finance charges on the account.

Page 282 PREV PAGE TOP OF DOC

Alternative Dispute Resolution: H.R. 833 allows the court to reduce an unsecured creditor's claim by up to 20 percent if a debtor can prove that any reasonable attempts to negotiate an alternative repayment schedule approved by a credit counseling agency were denied by the creditor. This provision could lead to fewer bankruptcy filings if more repayment agreements can be worked out as an alternative to bankruptcy.

Consumer Protections

Debtor's Bill of Rights: To ensure that consumers are not mistakenly steered into bankruptcy, H.R. 833 requires debt relief counseling agencies (popularly known as "bankruptcy mills") to provide detailed disclosures regarding the significance of bankruptcy and the nature of their services. Bankruptcy service providers also would be required to explain the alternatives to bankruptcy before the case is filed.

Consumer Education Provisions: H.R. 833 requires that, in order for a debtor to be eligible for bankruptcy relief, the debtor must receive credit counseling within the 90-day period prior to filing a bankruptcy petition. Additionally, the bill directs the Executive Office for U.S. Trustees to develop and test a pilot program on financial management for debtors, to help debtors avoid repeating their mistakes.

Protection of Post-secondary Education Savings: Under current law, savings earmarked for a child's college education could be liquidated in order to pay for debts claimed in bankruptcy. H.R. 833 protects such funds up to $50,000 per child, or $100,000 total, that have been placed in a qualified tuition program or in an education individual retirement account prior to one year before filing for bankruptcy.

Page 283 PREV PAGE TOP OF DOC

Protection of Retirement Savings: H.R. 833 also protects qualified tax-sheltered retirement plan assets from the claims of creditors in bankruptcy, regardless of whether the debtor has begun receiving payments from those funds. Current law only protects retirement fund distributions to the extent necessary for the support of the debtor and his or her dependents.

Reaffirmation Review: To further protect consumers in entering reaffirmation agreements, H.R. 833 gives debtors who choose to reaffirm unsecured debt the right to appear before a judge for a hearing on the agreement. A debtor who is represented by an attorney is free to waive the right to a hearing.

Educating Future Generations: The bill includes a Sense of the Congress Statement that personal finance curricula be developed for elementary and secondary education programs.

Bankruptcy System Accountability

Nondischargeability of Debts Incurred on the Eve of Bankruptcy: To address abusive "loading up" on debt by consumers prior to filing bankruptcy, H.R. 833 provides that consumer debts incurred to purchase luxury goods or services (aggregating more than $250 to a single creditor), or cash advances of more than $250 total, become nondischargeable if incurred within 90 days of filing. This strengthens existing laws by lengthening the time period (currently 60 days) and lowering the dollar amounts for both luxury purchases and cash advances (currently $1,000 each).

Debt Incurred to Pay Nondischargeable Debts: H.R. 833 attempts to curb abuses by those incurring dischargeable debt to pay for nondischargeable debt (e.g., paying for a student loan with a credit card check). In the bill, debts incurred within 90 days prior to filing for bankruptcy to pay nondischargeable debts themselves become nondischargeable. Debts incurred prior to the 90-day period to pay for nondischargeable debts become nondischargeable if it can be shown that this was done in order to discharge the debt in bankruptcy.

Page 284 PREV PAGE TOP OF DOC

Homestead Exemption: H.R. 833 imposes a two-year residency requirement before a debtor can claim the homestead exemption available in a particular state. The bill strengthens current law by discouraging some debtors from moving to a state with "softer" homestead laws for the purpose of keeping an expensive home after declaring bankruptcy.

Plan Length: H.R. 833 sets Chapter 13 repayment plans at a maximum of five years for those filers making more than the national median income. This improves current standards, which frequently set Chapter 13 plans at 3 years.

Tax Return Disclosure: The bill requires debtors to file three years of tax returns when filing for bankruptcy. If the debtor fails to file this information within set time frames, his or her case will be dismissed. Current law does not require filers to provide any tax return information, thus making it difficult to assess a debtor's finances as part of the bankruptcy case.

Valuation of Secured Claims: Under current law, inconsistent valuation methods are used throughout the country to value items that secure a loan. H.R. 833 values secured personal property at replacement value.

Improved Data Collection: The bill requires the clerk in each district to collect certain bankruptcy data and requires that those statistics be made publicly available. Additionally, an annual report of this data will be made to Congress so bankruptcy trends can be tracked.

Page 285 PREV PAGE TOP OF DOC

Creditor Representation at First Meeting of Creditors: H.R. 833 allows non-attorney representatives of any creditor holding a claim in a Chapter 7 or 13 case to be present at the first meeting of creditors.

Notice to Creditors: The bill requires debtors filing for Chapter 7 or 13 to send any correspondence regarding the bankruptcy to the address specified in his or her credit agreement, and must include the debtor's account number. All notices served on the creditor will not be effective unless these stipulations are followed. Upon request, the court shall provide to creditors key income information filed by the debtor in the case, such as the petition and schedules.

New Audit Provisions: H.R. 833 directs the Attorney General to establish procedures to determine the accuracy and completeness of petitions, schedules, and other information that the debtor is required to provide. Audits shall be performed on at least 0.4% of individual Chapter 7 and 13 cases, as well as schedules reflecting "greater than average variances from the statistical norm of the district in which the schedules were filed." Such audits shall be in accordance with generally accepted auditing standards and performed by independent certified public accountants or independent licensed public accountants.

DISCUSSION OF SELECTED ISSUES

Causation—Is it as Simple as Too Many Credit Cards and Too Much Credit?

Opponents of bankruptcy reform claim that the industry has created the problem by indiscriminately extending too much credit in the form of credit cards and simply wants to "turn the government into a bill collector". Nothing is further from the truth on a both a statistical and qualitative basis. First of all, if bankruptcy were simply a matter of too much credit, bankruptcy rates would be uniform across the country. In fact, they are not—they show wild variations across the nation and within the individual states. For example, Shelby County, Tennessee has a bankruptcy rate that is 32 times the national average—does Shelby County get 32 times the amount of credit that the rest of the country does? No, of course not. Well, then, if not too much credit, what does cause bankruptcy? The causes are very complex and frequently a number of factors are present. Some of the main causative correlations include divorce, lack of health insurance, lack of mandatory automobile insurance laws (7 states) and so on. Unemployment in and of itself is not a big factor. Urban areas have the highest bankruptcy rates—they also have the highest divorce rates. Young adults between the ages of 21 and 25 have low rates of bankruptcy filing, as do adults over the age of 41. The age group most likely to file are those in their early 30s, particularly age 32. Poor people and minorities have relatively low rates of overall filing while filings take off as you approach a total annual household income of between $32–36,000 and remain high thereafter. There is no way to really screen for most of these types of events and characteristics during the underwriting process. Should we not lend to 32 year olds? Should we ask applicants if they are happily married?(see footnote 16)

Page 286 PREV PAGE TOP OF DOC

What about credit cards? Bank credit cards account for approximately between 5 and 6 percent of total consumer debt. If you include other types of credit cards, you might get to 9 percent, depending on how you account for convenience users who pay off their balance every month. Is this 9 percent of consumer debt causing all of the problems while the other 91 percent maintains a benign budgetary impact? This is counterintuitive—, as all of us know, our big obligations are our housing, car, student loans etc. Do credit cards play any role in bankruptcy? Of course, but *they are in no way the principal cause*. In general, the role that credit cards play is that they are the last form of credit available for use before filing for bankruptcy. When a debtor gets into financial trouble for whatever reason, they will frequently try to float themselves using their credit cards, or if a debtor is planning to file a bankruptcy of convenience, they will frequently use their cards to acquire certain goods or make certain payments prior to filing. The industry has learned to identify some of this behavior and can sometimes reduce losses, but particularly in case of planned or non-insolvent bankruptcies, this is virtually impossible.

College Students and Credit Cards

Recent assertions and "projections" in the media about college students filing for bankruptcy because of credit card debt require careful review. As of 1996, the 18 to 25 year old age group accounted for about 8.7% of all filings(see footnote 17); the 21 to 25 year old portion of that age group had a filing rate less than half of the national median(see footnote 18). A national survey on student credit card use conducted by the Education Resources Institute and the Institute for Higher Education Policy makes findings substantially contrary to these recent assertions and unsurprisingly paints a much more complex picture of students and how they use credit: "The majority of students use credit cards responsibly and do not accumulate large amounts of credit card debt." Where students do encounter credit problems, one of the three characteristics frequently present in combination is the use of the credit card to charge tuition and fees. It is worth noting that the federal government has huge student loan programs involving large extensions of credit to students for college tuition and fees with no more than the hope that these students will find adequate employment after college. Federally insured student loans are nondischargeable in bankruptcy. Another finding of the survey is that 29 percent of all college students are so-called "non-traditional" students. These students tend to be older, part-time, financially independent, and often are married with children. These older, working students more frequently have some of the risk factors mentioned above.

Page 287 PREV PAGE TOP OF DOC

Like all bankruptcy causation issues, college students and credit cards is not susceptible to a simple explanation and many of the anecdotes bandied about have little value in a policy discussion. There is no serious evidence of a problem.

The Needs Based Provisions

Much of the controversy around H.R. 833 centers around the needs based provisions of the bill designed to make sure that those debtors with meaningful ability to pay actually do so. Below is a more detailed discussion of the provisions that illustrate that they achieve this goal in a fair, straightforward and flexible manner.

In brief, the test takes the debtors current monthly income, if it is above the national Household Median income, subtracts expenses and secured and priority debt payments, and determines whether the remaining income is high enough for the debtor to pay his unsecured creditors $5,000 or 25% over five years:

a). The Debtor's Current Monthly Income

(Must equal 100% of Median National Income for Household size ($51,000 for a family of four) or the means test does not apply)

b) *Minus:* Monthly expenses determined by IRS standards
c) *Minus:* Average monthly secured debt payments
d) *Minus:* Average monthly priority debt payments

Page 288 PREV PAGE TOP OF DOC

e) *Equals: Monthly income available to pay unsecured debts.*

A determination is then made to see if the debtor has enough income left over to pay 25 percent of unsecured debts or $5,000 over five years.

f). *Take into account "extraordinary circumstances."*

Loss of a job, divorce, high medical bills or other circumstances can be taken into account by the judge, giving him or her the discretion to reduce income or increase expenses under the means test.

Thus the test is designed to establish an extremely high threshold that must be met before *any* debtor would be impacted at all. Specifically, the means test would affect the debtor only if they made above the National Median Income and if after paying *all* the debtor's expenses, *all* the of the debtor's monthly secured debt payments, *all* of the debtor's monthly priority debt payments and any special circumstances, does the debtor has sufficient income to pay 25 percent or $5,000 of their unsecured debts to their creditors.

The Elements of the Needs Based Provisions:

a.) Current Monthly Income

The first step in applying the means test is to determine the debtor's current monthly income. For purposes of the means test, the debtor would estimate current monthly income by taking his or *her average monthly income over the six months preceding the bankruptcy filing*. H.R. 833 uses an average calculation because of the month to month income fluctuations: taking a "snapshot" of a person's monthly income in any particular month may result in an over or under estimation of a person's income. For example, a six month *average* may understate monthly income because it may exclude bonuses and other upward adjustments to income that may occur outside the six month period. However, the means test is this case simply gives the debtor the benefit of the doubt in order to implement a simple test that is simple to utilize. As a result, if the six-month calculation understates the debtor's typical montly income, the debtor is under no obligation to correct the understatement.

Page 289 PREV PAGE TOP OF DOC

On the other hand, the test *does* address situations where the debtor's income has been overstated. Specifically, the "extraordinary circumstances" provisions of the test are designed to take a debtor's particular circumstances into account, including, for example, the loss of a job, a divorce, or high medical bills. In addition, even if the debtor's case is ultimately sent to Chapter 13, the debtor may decrease his or her payment at anytime if he or she experiences a decrease in income or an increase in expenses.

If the debtor's income is below the median household income for a family of that size, $51,000 annually for a family of four, then the means test does not apply to the debtor. This is important to note, because it means that only high income households are impacted by the means test.

b). IRS Expense Allowances

Once the monthly income is determined, and it is higher than the median household income, the next steps are to subtract the debtor's expenses from his or her income. Considerable flexibility is built into the calculation of expenses for the debtor. Specifically, the calculation uses three broad categories of expenses which have been employed by the IRS: (I) National Standards; (II) Local Standards; and (III) Other Necessary Expenses. *Generally, the debtor's actual expenses, rather than numbers specified by the IRS, are used.*

1). National Standards. National Standards cover items such as *apparel* (e.g., shoes and clothing, laundry and dry cleaning), *food, housekeeping supplies* (e.g., postage and stationery, laundry and cleaning supplies, household products, paper goods and garden supplies), and personal care products and services (e.g. hair care products, shaving needs, cosmetics), as well as a miscellaneous category of expenses. For these expenses, the IRS has specified allowable dollar amounts which vary depending upon the debtor's income and household size. The dollar amounts specified by the IRS are based upon the consumer expenditure survey conducted by the Bureau Of Labor Statistics ("BLS").

Page 290 PREV PAGE TOP OF DOC

2.) *Local Standards.* The Local Standards cover residential and transportation expenses, such as *rent, parking, maintenance and repairs*, renter's insurance, utilities, the *cost of leasing and operating a car, parking fees*, tolls, public transportation and other similar expenses. The Local Standards are intended to take geographic price variations into account, and they are therefore based on the cost of housing and transportation in the county where the debtor lives.

However, the Local Standards are also designed to *use the debtor's actual expenses* rather than the IRS standards. For instance, when the debtor owns a car or house, the *debtor's actual average monthly mortgage and car loan payments* are used. (See the discussion of Average Monthly Secured Payment, below.)

3). *Other Necessary Expenses.* Finally, the means test has broad allowances for expenses that fall into the "Other Necessary Expenses" category. These additional expenses include *taxes*, *child support and alimony payments*, and other court ordered payments, *child care*, *expenses for the care of dependents*, *education* for physically or mentally challenged dependents education expenses that are necessary as a condition of employment, *health care*, and other miscellaneous expenses. The IRS has not specified any dollar amounts applicable to those categories. Instead, for purposes of the means test, the debtor uses his or her own *actual* expenses for each of these categories, *thus giving the debtor further flexibility in tailoring the means test to reflect his or her actual expenses.*

c). Average Monthly Secured Debt Payments

Page 291 PREV PAGE TOP OF DOC

The means test also takes into account the debtor's monthly payment due on secured loans, such as mortgages and car loans, and subtracts this from the debtor's current monthly income. By taking these payments into consideration, the means test allows the debtor to keep his or her house and car and other secured property. Thus, it represents yet another way in which the needs based calculation reflects *personal*, *individualized* circumstances of the debtor. Average monthly secured debt payments are calculated by taking debtor's monthly payment due to secured creditors in each month of a hypothetical five year Chapter 13 plan and dividing that total sixty months.

d.) Average monthly Priority Debt Payments

The means test also ensures that debtors have enough income to pay all of their priority debts, such as *child support*, unpaid wages, *taxes* and other important debts before it attempts to calculate whether or not there is any income left to pay unsecured creditors. Thus it is also designed to take each debtor's personal circumstances into account. It is calculated by taking the debtor's expenses for payment of all priority (including priority child support and alimony support) and dividing the total by sixty months.

e) 25% of Unsecured Debt or $5000 over Five Years

The remaining income is then inspected to determine if the debtor has enough remaining income to, *pay either 25% of their unsecured debt or $5000 over five years*, which ever is less. If there is insufficient income remaining, then the debtor is not affected by the means test.

Page 292 PREV PAGE TOP OF DOC

f) "Extraordinary Circumstances"

Even if the after the application of the test, the debtor still has an opportunity to highlight any *extraordinary circumstances* to the bankruptcy judge, which gives the bankruptcy judge an opportunity to exercise his or her *discretion* and make an adjustment to the debtor's income or expenses. For example, a bankruptcy judge could take into account a debtor's loss of a job, divorce or high medical bills, for example, and could reduce the debtor's income or increase their expenses under the test accordingly.

Thus, the means test attempts to take a debtor's unique circumstances into account, and in effect represents an attempt to "weed out" from consideration those debtors who do not have the income to pay back their unsecured creditors. However, it seeks to ensure that those who can pay back a portion of their debts are required to do so by using a easy to apply, generous formula with judicial discretion to take special circumstances into consideration.

Restoring Balance Between Different Types of Lending—The Cramdown

In 1978, during the last major overhaul of the bankruptcy code, one of the major changes that unbalanced the code between debtor and creditor and, in our view, has provided a substantial impetus to the increase in bankruptcies of convenience is the extraordinary device known as the "cram-down".

This is a statutorily based mechanism, found in Section 506(a) of the Code, which provides that every claim filed which is secured by a lien on property is an "allowed secured claim" to the extent of the creditors interest in such property. To the extent that that creditor's interest is less than the total amount of the claim, the claim is an allowed "*un*secured claim." Under the present Code, a secured claim cannot be an allowed secured claim in an amount greater than the value of the collateral.

Page 293 PREV PAGE TOP OF DOC

As written in the National Consumer Law Center's *Consumer Bankruptcy Law and Practice*, the cram down power provided to the Bankruptcy Court in favor of the debtor by the 1978 Code represents a significant example of a statutorily-supported wealth transfer between a debtor and creditor:

One of the greatest advances for consumers under the (1978) Bankruptcy Code came in the powers they were given with respect to secured debts. Under the prior Bankruptcy Act, relatively little could be done to protect consumer debtors from the holders of such claims. A straight bankruptcy did not generally affect the status of otherwise valid liens or security interests and, as a practical matter, few Chapter XIII plans could get very far with respect to secured claims unless the holders of those claims agreed to the plan or were not affected by it. Now, in contrast, almost every conceivable type of security interest can be altered in some way through bankruptcy, often to a tremendous degree and with very significant benefits for the debtor.
Consumer Bankruptcy Law and Practice, 4th Ed., p. 203.

The workings of the cram down with both real estate and non-real estate have created a large body of law on this mechanism alone. The most recent significant case on how to value collateral for the purposes of determining how to determine the value of the allowed secured claim was *Associates Commercial Corporation* v. *Rash*, which provided that the value of a creditor's collateral for cram down purposes should be what the debtor would have to pay for comparable property ("the replacement-value" standard).

Secured credit is usually the only "deep pocket" in a consumer bankruptcy case. Since 1978, debtors' advocates have been moderately successful in "unlocking" the secured creditor's pocket through cram downs, "ride throughs", nonpayment while a plan is being confirmed, Chapter 13 conversions to Chapter 7 after cramdown or cure, and the like.

Page 294 PREV PAGE TOP OF DOC

These various developments erode the fundamental distinction between secured and unsecured credit. There are very definite reasons that a lender chooses to extend secured credit over unsecured credit and one of them is certainty of repayment. H.R. 833 addresses these issues to varying degrees and AFSA supports these provisions prior to filing Secured lenders for items such as vehicles, boats etc. suffer the greatest losses on cramdown in the early years of vehicle or vessel life when depreciation is the greatest. AFSA believes that this is an important fact in pre-bankruptcy planning.

CONCLUSION

Again, AFSA appreciates the opportunity to express its views. We strongly support the efforts of the Committee to develop a modern legal framework for bankruptcy and urge you to move forward with H.R. 833.

Table 1

Mr. **BRYANT.** Mr. Moore.

STATEMENT OF MICHAEL MOORE, BADCOCK HOME FURNISHING CENTERS, GAINESVILLE AND CORNELIA, GA, ON BEHALF OF THE NATIONAL RETAIL FEDERATION

Mr. **MOORE.** Good morning. My name is Michael Moore. I am a proud owner and operator of two Babcock Home Furnishing Centers in Georgia, one in Gainesville, the other in Cornelia. I am testifying today on behalf of the National Retail Federation, of which the Badcock Company is a member. In addition, Badcock is a member of the National Home Furnishing Association, a group that is also supportive of H.R. 833.

Page 295 PREV PAGE TOP OF DOC

I would like to thank you, Mr. Chairman, for the opportunity to testify before this distinguished committee today.

I know we have a lot of bankruptcy experts here today. I am not one. I am here to give you the perspective of the independent store that has to deal with the bankruptcy problems on a day-by-day basis. I am here to speak on behalf of hundreds of retailers and furniture dealers throughout the country. My relationship with Badcock allows me to grant credit to my customers, but I ultimately bear the responsibility for any bad credit decisions, including customers who file for bankruptcy protection.

I would like to briefly address three points today. What are the trends and costs of bankruptcy? What are the common misunderstandings about the process that my customers are seeing? Where are some of the serious misuses and abuses actually taking place?

In one of my stores, bankruptcy losses over the last 4 years—we are talking about a small business. We are talking about two stores that do approximately $2.3 million a year in retail sales, a staff of 10 people. Over the last 4 years, my bankruptcy filings are a total of $116,267. This equates to approximately $29,000 on an annual basis.

Mr. **CHABOT.** Could you pull that mike a little closer, please?

Mr. **MOORE.** The total losses were $116,267, which equates to about $29,000 on an annual basis. And, as I mentioned, understand this is a small business. In operating a small business like this, as all of you know, the major expenditures are rent, payroll, utilities, expenses that I can actually control. Rent factors, I can negotiate. Payroll, if necessary, I can cut back. Utilities, we cut back 18 percent last year. This is something we could do. We had the local utility company send their experts in, show us were to put insulation, to cut back thermostats. We control these expenses.

Page 296 PREV PAGE TOP OF DOC

I have no control over bankruptcies at all. We use integrity when we determine whether or not a customer receives financing in our stores. We determine the level. Knowing the problems that we have here we would be foolish to extend credit out to someone knowingly that is going to end up on this sheet, which is going to end up as an expenditure at the end of the year.

The losses I had occurred, if just added to my bottom line, would give me a 30 percent increase in pay last year. That gives you an idea of what the bottom line is. Do your math.

I think that the thing that we have got with the bankruptcy losses in my stores, the actual figure dollarwise is 500 percent, over the last 4 years, 300 percent in the other store. I have spoken with many other retailers, and their losses have increased at a similar rate. Taking into consideration we have had good sales increases, we are very fortunate to have our businesses, but if the bankruptcy losses continue at the rate they are of the last 4 years, I will be out of business.

I have 25 years. I started this as a teenager. I was educated in the business, and I love the business and would very much like to stay here. The misunderstandings that I am seeing as a retailer, many people think that they are getting debt consolidation.

Understand, I am in Small Town, USA. I am outside of Atlanta, where one of our stores is in the bedroom community; the other is in an 18,000 population town. These people I see every day, they are at the ball games with my kids. My kids go to school with them. They go to church together.

Page 297 PREV PAGE TOP OF DOC

These are not strangers. These are my customers. They have come in and recently, in the last 2 weeks, I have had customers—most recently, in the last 2 weeks, and this happened many times before, customers come in and actually say and be proud of themselves, Mike, I know I was behind on my bill. I just wanted to talk to you and tell you I have consolidated my debt and that we will get back on track on our payments.

And I would have to say, honey, come to my office, let me show you something. They didn't even realize they filed. They were being told that there was debt consolidation. It is in our phone books. It is on the TV screens. It is in our newspapers, advertising regards to debt consolidation. If it is a horse, call it a horse. I think that lawyers need to provide a disclosure—or advise the consequence and have a disclosure at the time of filing.

Like I say, I am not a bankruptcy expert. I just know what is happening to me and my businesses.

Misuse and abuse. I brought with me, and I will make it very quickly, I know I have a red light here, but this is an abuse. This customer that had purchased from me on 8/14/98—I have all documentation, CBI, credit bureau investigation, all of the things that we would normally use to determine if this customer was creditworthy, was up to par, their willingness to pay, their ability to pay. Everything was there. They had a good job, on the job over 2 years, da, da, da. They had high credit. Everything was great.

They purchased from me on 8/14/98. 32 days later, 9/16/98, I received filing papers. I had not even sent them the first statement yet. To us it is a big purchase, $914, just as an example.

Page 298 PREV PAGE TOP OF DOC

People repeatedly filing. We have dismissals within 30 days. Before we can even act on getting them in the mail that there is a dismissal, get our people out there, talk with the customer, they have already filed again.

Bankruptcy ought to be there for those people that generally need it. I know those people, and I support it. But before people file, they should be educated and something—certainly they should understand the consequences of filing and the aftereffect.

I hope your bill would do just that. And I do appreciate your time.

Mr. **BRYANT.** Thank you, Mr. Moore.

[The prepared statement of Mr. Moore follows:]

PREPARED STATEMENT OF MICHAEL MOORE, BADCOCK HOME FURNISHING CENTERS, GAINESVILLE AND CORNELIA, GA, ON BEHALF OF THE NATIONAL RETAIL FEDERATION

Good Morning. My name is Michael Moore. I am the independent owner and operator of two Badcock Home Furnishing Centers in Georgia—one in Gainesville, and the other in Cornelia. I am testifying today on behalf of the

National Retail Federation, of which the Badcock Company is a member. In addition, Badcock is a member of the National Home Furnishing Association, a group that is also supportive of H.R. 833. I would like to thank the Chairman for providing me with the opportunity to testify before this distinguished Committee today.

Page 299 PREV PAGE TOP OF DOC

The National Retail Federation (NRF) is the world's largest retail trade association with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalogue, Internet and independent stores. NRF members represent an industry that encompasses more than 1.4 million U.S. retail establishments, employs more than 20 million people—about 1 in 5 American workers—and registered 1998 sales of $2.7 trillion. In its role as the retail industry's umbrella group, NRF also represents 32 national and 50 state associations in the U.S. as well as 36 national associations representing retailers abroad. NRF's members and the consumers to whom they sell are significantly impacted by the recent surge in consumer bankruptcy filings.

As an independent furniture owner, my relationship with Badcocks allows me to finance and grant credit to my customers. They arrange the financing that I provide for my customers, but as an independent retailer, I am ultimately responsible, and the success or failure of a customer to make payments affects my store. Ultimately, I bear the responsibility for my credit decisions. The losses attributed to write-offs and bankruptcies directly affect *my* stores' bottom line. Over the past several years, I have seen a dramatic increase in consumer bankruptcy filings among my customers—and it has had a devastating impact on my business. In fact, in the past few years, bankruptcy losses in my two stores have increased well in excess of 200 percent. Sadly, this situation is not unique to my furniture dealerships. My conversations with other retailers have revealed that their losses have increased at an equally alarming rate.

It is important to note that during the period in which I have seen my bankruptcy losses soar, my business practices have not changed. I have continued to use the same careful standards for granting credit. In fact, because of the nature of my business, I often personally sit down with my customers before they make a purchase on credit to determine exactly how much debt they can afford to take on, and what types of terms and payment schedule they can handle. I want to make sure that they can and will be able to make good on their responsibility.

Page 300 PREV PAGE TOP OF DOC

In my experience, much of the recent surge in bankruptcies results from changes in consumer attitudes regarding debt repayment, misunderstandings about the bankruptcy process, and/or some misuse of the system. I am experiencing a phenomenon that is extremely difficult to deal with, and otherwise hard to explain: good customers with good payment histories who are making purchases in my store and then filing for bankruptcy 30–90 days afterwards.

(As I talk to my customers about why they have filed for bankruptcy), I have come to learn that there is a great deal of misinformation that many of them receive during the bankruptcy process. In fact, it has become clear to me that many customers go into bankruptcy without the proper information or legal advice. Sometimes it appears they are actually misled into filing for bankruptcy. Some consumers have been enticed by *bankruptcy mills*—businesses or law firms which purport to help consumers "consolidate" or "manage" their debts, but actually steer consumers into filing bankruptcy petitions regardless of whether they need to do so. Some of these individuals do not even understand that they have filed for bankruptcy. Others do not know why they have filed in a particular chapter, or what the consequences of their decisions are. I have seen a number of cases where the individual simply needed consumer credit counseling and an explanation of the various alternatives and resources available to them.

It is my understanding that a bill before Congress, H.R. 833, would make several important changes to help ensure that consumers are not mistakenly steered into bankruptcy, or into the wrong chapter. H.R. 833 includes provisions that would require bankruptcy mills to provide detailed disclosures regarding the significance of bankruptcy and the nature of their services. Bankruptcy service providers would also be required to explain the alternatives to bankruptcy before the case is filed. It is my understanding that the legislation would also ensure that debtors receive credit counseling within the 90-day period before filing for bankruptcy. Again, in my experience, if some of my bankrupt customers had received proper counseling, they would never have needed to file. I believe it is extremely important to give consumers tools such as these to enable those who do not truly need bankruptcy protection to work through their financial troubles and manage their debt, thereby avoiding bankruptcy and preserving their credit.

Page 301 PREV PAGE TOP OF DOC

Aside from these misunderstandings about bankruptcy, I have also seen what appear to be deliberate abuses of the current system. Under the current law, individuals can file a chapter 7 once every six years, and refile a chapter 13 numerous times. I have literally seen customers who have refiled for bankruptcy the same month that they received their discharge from the prior bankruptcy plan. This is a deliberate misuse of the current system.

Furthermore, I have an increasing number of customers who file for bankruptcy within a short period of time after making a major purchase. These individuals apparently are loading up on goods *at the same time* they are visiting their bankruptcy attorneys. Indeed, I've had people file for bankruptcy after buying, but before they receive their first monthly statement. In one situation, a customer bought a $2,000 big screen television within several weeks of filing. Ironically, it was the retailer who had to spend over $500 in attorney's fees trying to get the television back. Our laws must be tightened to prevent those who are deliberately using the Bankruptcy Code as a tool to load up on merchandise on credit that they have no intention of ever repaying.

Finally, some consumers are using Chapter 13 to reduce the contract price (and other terms) of purchases they make from dealers who hold a security interest in the merchandise. It is unfair for an individual to purchase a $500 dining room set on sale, and then turn around 4 months later and claim that its value should be crammed down to $75 or $100 when they file for bankruptcy. There should be a reasonable period during which this kind of abuse should not be tolerated. Beyond that period, there should be a requirement that the secured goods be priced at a fair market value based on what they would sell for in an open retail environment, such as at a good used furniture store, not the firesale prices some attempt to use now. H.R. 833 does contain a fair valuation provision, and we support it.

Page 302 PREV PAGE TOP OF DOC

In closing, I urge Congress to move swiftly to enact legislation that would restore the principles of fairness and personal responsibility to our bankruptcy system. I believe we should give consumers the tools to understand the consequences of bankruptcy, while at the same time reform those provisions of the current Code that allow some individuals to game the system and misuse bankruptcy as just one more financial planning tool. Ultimately, we must return our bankruptcy system to its original mission: a safety net intended to provide a fresh start for only those individuals *truly* in need.

Mr. **BRYANT.** Before I recognize Mr. Sigmon for his statement, I want to first recognize Representative Joe Scarborough from Florida, who technically is not a member of the full committee and this subcommittee yet, but we anticipate will be a member of this subcommittee and committee once we have a floor vote, which should occur fairly shortly. But, accordingly, we do want to welcome you.

And, at this time, I think the last member of this panel, Mr. Sigmon, is prepared to present his testimony.

STATEMENT OF WAYNE SIGMON, ESQUIRE, GRAY, LAYTON, KERSH, SOLOMON, SIGMON, FURR AND SMITH, PA, GASTONIA, NC, ON BEHALF OF THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS

Mr. **SIGMON.** Thank you very much.

Mr. Chairman, members of this panel, I would like to say thank you very much for giving me this opportunity to appear today and speak.

Page 303 PREV PAGE TOP OF DOC

I am a bankruptcy attorney. I have practiced bankruptcy law for approximately 20 years. If this were a war, I guess I am one of the soldiers. I am there every day, meeting with the people, going to court.

I practice in the Western District of North Carolina. I do chapter 7s and chapter 13s. I am also a member of the Panel of Chapter 7 Trustees. So I get to see it from both ways.

Like, Mr. Moore, I come from Small Town America. Gastonia is not a very big town. Most of our clients are blue-collar workers. Their income would be below the national median. North Carolina is only one of four States that does not have wage garnishments for judgments. Even though that is true, the great majority of our low-income debtors file chapter 13s rather than chapter 7s.

The reason they file chapter 13s is that our court has developed an efficient and I think very balanced way of working the chapter 13 system that helps everybody. In our court already we do a lot of things that are proposed in this legislation. For example, we have a rule by case law that says that if you have purchased property within the past 180 days, you have to pay the full value of that property. We have done that for years. It has gotten away from any recent purchase problems that we had before.

The point I want to talk about today is that I am not going to discuss the means test. Everybody and their Aunt Matilda is talking the means test. But there are a lot of other provisions in this bill that I think would have significant effects on chapter 13 practice, especially for the low-income filer.

Page 304 PREV PAGE TOP OF DOC

The first one is section 124, which I am calling the anticlaim bifurcation rule. What it does is prohibit splitting of claims on purchase money for security interests on personal property purchased within 5 years of the date of the filing. For example, say a debtor files with a car purchased 2 years before with a replacement value of $10,000 and a debt of $15,000. Under the current law, the creditor would have a secured claim of $10,000 to be paid with interest, plus an unsecured claim of $5,000 to be treated like other unsecured claims.

In this way that creditor receives through this chapter 13 case really more than that creditor would get if he foreclosed. And the reason I say more is that he gets the present value of the car, without the deduction of the disposal cost.

Now the overage, the other $5,000, is treated like an unsecured debt, just like the overage would be treated in the real world if no bankruptcy were filed and the creditor foreclosed.

In my opinion, the bifurcation rules that came out in the 1978 Code benefit other creditors as much or more than they benefit debtors. It causes the other unsecured creditors to be treated equally as to this creditor and the portion of his debt that is unsecured.

Also, as to debtors, if they are in a chapter 13 case under H.R. 833, and they have to pay, as the law proposes, the full value of this claim with all the contract interest rate, which would be $15,000, plus contract interest, plus costs, low-income debtors are going to choose chapter 7 over chapter 13. Because everything for a debtor in chapter 13 or everything for a debtor in credit life, I believe, is payment driven. Can I afford that payment?

Page 305 PREV PAGE TOP OF DOC

And the debtors, if they have to pay the full values, they are not going to be able to afford it. Their payments are not really going to go down significantly.

So this bill wants to move people over to chapter 13 from chapter 7. It is going to move the people that, at least in our area, are now filing chapter 13s into chapter 7s, just because they can't afford to make these giant monthly payments with interest rates of 18 and 20 percent, et cetera, et cetera.

And also I want to point out to the committee that a lot of car loans I see are now 6 and 7 year car loans with 18 and 20 percent. They just can't afford it. What I would propose as a reasonable compromise to the antibifurcation rule is that a 6-month recent purchase rule be instituted, like what I talked about in our district that works. It prevents the abuse, and it doesn't prevent low-income people from filing chapter 13s.

Another provision I want to talk about quickly is section 137. It is called adequate protection of lessors and purchase money secured creditors. If you read it closely, what it requires is that the debtor make direct, adequate protection, contract amount payments to secured creditors and lessors and, at the same time, to begin making their proposed chapter 13 plan payments; and those plan payments include a component which has the same payment of adequate protection for the same creditors in it. In other words, at the inception of the case, until the trustee start making payments, the debtors are making double payments.

Again, obviously, that will not work. That is impossible. These people can't even afford the payment, much less double payments.

Page 306 PREV PAGE TOP OF DOC

A possible solution to this would be to require the debtor to begin escrowing their plan payments with the trustee at the filing date and authorize the trustee by statute so that he is not in trouble under his bond to pay—start making payments to secured creditors 30 days after the case is filed. That way we have solved the problem, if there is a problem, of waiting too long to pay secured creditors, without forcing people out of the system.

There is—I see that I have the red light, and I am just going to talk real quickly about two more provisions.

One is the notice provision. I am just going to say real quickly that the notice provision, as written, I think, is messed up. What it seems to say is that if the creditor does not provide the debtor with a bankruptcy notice address on his bills and statements and does not file a master address with the clerk of the court, that creditor has a safe harbor. I don't think that is what was intended.

What was intended was for the creditor to give a bankruptcy address to use and then have a safe harbor. It is written in such a way that it just doesn't work.

One more point. Debtors' duties, requiring debtors to file tax returns for the past 3 years. If you ask 50 percent of my debtors where their tax returns are, they will say, H&R Block, I guess. Most of my low-income debtors just do not know where the tax returns are.

The bill requires them to file them within 45 days subject to automatic dismissal with one extension of 45 days. I don't know if you people have tried, but if you go to the IRS and try to get a tax return within 90 days, good luck. You are not going to get it. Again, it won't work.

Page 307 PREV PAGE TOP OF DOC

One more point. As a chapter 7 trustee reviewing consumer cases, I don't want all of these tax returns. I don't need them for these low-income people. If I need them, I can get them. We have rules. We have subpoenas. We can get them now under the present rules. These tax returns are going to create mountains of paper at the bankruptcy court. We don't need them.

Thank you.

[The prepared statement of Mr. Sigmon follows:]

PREPARED STATEMENT OF WAYNE SIGMON, ESQUIRE, GRAY, LAYTON, KERSH, SOLOMON, SIGMON,

FURR AND SMITH, PA, GASTONIA, NC, ON BEHALF OF THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS

SUMMARY

Though debate has centered upon the "means test" provisions of proposed bankruptcy legislation, H.R. 833 contains other provisions which would have an equally significant impact especially upon Chapter 13 cases. The stated purpose of the proposed legislation is to cause debtors who can afford to pay some of their debts into Chapter 13 rather than Chapter 7. However, little has been noted about the practical effects of the proposed changes to Chapter 13, both for consumers who are forced into Chapter 13 by the "means test" and for the many low income consumers who would choose Chapter 13 over Chapter 7 in order to save their homes, vehicles, and personal possessions.

This paper is an attempt to analyze the substantive changes to Chapter 13 made by H.R. 833 with emphasis on the practical effect. Also, this paper contains the observations of a Chapter 7 panel trustee about the effects of the proposed legislation.

Page 308 PREV PAGE TOP OF DOC

STATEMENT

The writer is an attorney who has practiced bankruptcy law almost exclusively for the past twenty years in Gastonia, North Carolina. He represents between five and six hundred Chapter 7 and Chapter 13 debtors per year and he serves as a court appointed panel trustee in approximately 350 consumer Chapter 7 cases per year.

Gaston County, North Carolina contains approximately 200,000 residents, and is located approximately twenty miles west of Charlotte. The majority of its residents are blue collar workers in households whose income would fall below the National Median. Gastonia, North Carolina is a part of the Western District of North Carolina. The Western District of North Carolina averages approximately 7,000 case filings per year.

Curiously though North Carolina does not have a wage garnishment law, the great majority of consumer debtors who file in the United States Bankruptcy Court for the Western District of North Carolina file Chapter 13 cases. This is true because the court and bar have developed an efficient and effective Chapter 13 system that helps the consumer debtors save their homes, cars and personal property while paying what they can to their unsecured creditors.

A very important feature of the Chapter 13 program in North Carolina, and elsewhere, is the cooperation of the courts and consumer debtors' attorneys in allowing for the payment of all, or at least a substantial portion, of Chapter 13 debtor's attorney's fee by deferred payments by the trustee. Most prospective Chapter 13 debtors could not afford to pay the entire attorney's fee in advance of the filing of their case, but are able to do so when the fee is included as a claim in their Chapter 13 plan, and paid over time along with the claims of their other creditors.

Page 309 PREV PAGE TOP OF DOC

To be sure, the deferral of the payment of the fee in this manner does increase the chance that the Chapter 13 attorney will not be fully compensated for his or her services. However, the willingness of the attorney to share the risk of the ultimate success of the repayment plan has resulted in making Chapter 13 an affordable option for many more residents of our State and Nation.

Over the past twenty years the nature of the people I work with has not changed. The great majority were, and still are, honest, hard-working people who for whatever reason, have encountered financial problems.

What has changed, especially in the last ten years, is the nature of consumer lending. With deregulation of interest rates and increased competition, it would have been logical to assume that consumers loan interest rates would have dropped. But, that has not happened. Rather, the consumer credit industry has drastically lowered its standards and made credit available to almost anyone regardless of credit history and without any meaningful credit check. Also, the consumer credit industry now regularly extends loans "secured" by real and personal property in amounts which greatly exceed the value of the collateral. The requirement of a "down payment" has, in many cases, disappeared from consumer credit transactions. It is against this background that I will attempt to analyze H.R. 833.

The purpose of this paper is to analyze the practical effects of H.R. 833 on consumer debtors in the Western District of North Carolina with emphasis on the effects on Chapter 13. Also, where applicable, the practical effects on creditors and Chapter 7 trustees will be noted. Contrary to national popular belief, the bankruptcy system as it is operating at least in the Western District of North Carolina is efficient, balanced and is not being abused to any significant extent. As a Chapter 7 panel trustee, I can unequivocally say that I have seen very few cases of abuse in the bankruptcy system in my twenty years of experience. In the few cases where there was abuse, I was able as trustee to thwart the debtor's efforts through alternative actions such as objections to discharge. Therefore, my experiences do not indicate that drastic changes to the Bankruptcy Code are warranted.

Page 310 PREV PAGE TOP OF DOC

H.R. 833 contains a number of provisions which are positive refinements and should be enacted. They include:

1. Section 123 which would provide for the secured creditor's retention of its lien on property of the debtor until the payment of its claim in full, or the entry of the order discharging the debtor,

2. Section 116 which would require a creditor to properly credit to its account any payments that it receives under a bankruptcy plan of reorganization,

3. Section 601which would allow creditors, at their election, to appear and participate in meetings of creditors without being required to be represented by legal counsel.

4. Section 107 which requires a clear and concise written fee agreement.

However, H.R. 833 would drastically and fundamentally change the landscape overnight for consumer Chapter 7 and Chapter 13 debtors and for the attorneys who represent them in Bankruptcy Court. H.R. 833 purports to limit the availability of Chapter 7 relief to a large number of consumer debtors and this goal will clearly be accomplished by the legislation. However, the legislation will also "shut down" the current Chapter 13 bankruptcy system. Various provisions to be discussed, such as the anti-claim bifurcation rules, the 5 year contract valuation rules, the direct cash payments to secured creditors at the contract rate rules, the delayed confirmation process, and the numerous exceptions to the automatic stay simply create a new Chapter 13 that will not work in the real world.

Page 311 PREV PAGE TOP OF DOC

5. Section 102. Dismissal.

This is the "means test." Though it is certainly a central part of the legislation which has been extensively debated, its practical effects on Chapter 13 cases are no more extensive than many of the less debated provisions discussed below.

Legislative Changes

Section 102 of H.R. 833 amends 11 U.S.C. §707 to provide for the dismissal or conversion of a Chapter 7 case upon a finding of abuse. The "substantial abuse" provision has been removed from this section by H.R. 833. Abuse is presumed to exist if the debtor's current monthly income (as defined by amended §101(10A)) less expenses (as defined in amended §707) and multiplied by 60 months is not less that 25 percent of the debtor's nonpriority unsecured debt in the case or $5,000, whichever amount is less. Current monthly income is defined in section 102 of H.R. 833 (new §101(10A)) as the average monthly income from all sources whatsoever, without regard to whether it is taxable, which is received within 180 days of the petition date. Section 102 of H.R. 833 then provides that for purposes of dismissal based on abuse, you must deduct the following from current monthly income: the IRS monthly expenses "for the area in which the debtor resides" as of the filing date; the average monthly payments on account of secured debts (calculated as all contractually due amounts in each month of the 60 months following the filing of the petition divided by 60); and, the debtor's expenses for all priority claims including priority child support and alimony (calculated as the total amount of debts entitled to priority and divided by 60).

Page 312 PREV PAGE TOP OF DOC

Section 102 of H.R. 833 amends §707(B) to provide that the presumption of abuse may be rebutted only for extraordinary circumstances with respect to additional expenses or current monthly income. Both the debtor and the attorney for the debtor must attest under oath as to the accuracy of any information provided for in this petition. In addition, extraordinary income and expense information must result in a net disposable income, when multiplied by 60, that is less than 25 percent of the debtor's nonpriority unsecured claims or $5,000, whichever amount is less. Code section 707(C)(3) (as amended by H.R. 833) provides that if the presumption of abuse does not apply or has been rebutted in a contested case then the court shall still consider whether the debtor filed the petition in bad faith or if the totality of the circumstances of the debtor's financial situation demonstrates abuse.

Code section 704(10) provides that 10 days prior to the 341 meeting the Panel Trustee or the Bankruptcy Administrator shall file a statement with the court as to any finding of presumed abuse under 707(b) and the court shall serve such finding on all creditors within 5 days of receipt. Upon a finding of such abuse, and if the debtor's current monthly income when multiplied by 12 is not less than the highest national median income applicable, the Panel Trustee or the Bankruptcy Administrator shall within 30 days file a motion to dismiss or convert or a statement setting forth the reasons they believe such a motion would not be appropriate. If such a motion is filed and granted and if the court finds that the action of the attorney for the debtor was not substantially justified, then the court shall order the attorney to reimburse the Trustee for all reasonable costs in prosecuting the motion, including reasonable attorneys' fees. If the court also finds that the attorney violated Rule 9011, then at a minimum the court shall order the assessment of an appropriate civil penalty against the attorney and the payment of the penalty to the Trustee.

Page 313 PREV PAGE TOP OF DOC

If the motion to dismiss for abuse is filed by a party other than the Panel Trustee, the United States Trustee, the Bankruptcy Administrator, or a party with an aggregate claim of less than $1,000, and is not granted, then the court may award the debtor all reasonable costs in contesting the motion, including a reasonable attorneys' fees, if the court finds the position of the party that brought the motion was not substantially justified or the party brought the motion solely for the purpose of coercing the debtor into waiving a right guaranteed to the debtor under Title 11.

Practical Analysis of Provisions

One example of an item the formula does not take into account is payroll deductions for loans for qualified retirement plans. Under H.R. 833, these loans may not be modified under Chapter 13 and the creditor does not violate the stay by the continuation of the wage deduction. Another examples arises out of the Religious Liberty and Charitable Donation Protection Act of 1998. This act amended Code sections 548, 707(b) and 1325(b)(2)(A) of the Code. Generally speaking, the debtor may commit up to 15% of his annual gross income for a qualified charitable contribution. Such a contribution may not be considered for purposes of Chapter 7 abuse or Chapter 13 confirmation. However, this type of expense is not covered by the new income and expense rules.

Another omitted expense relates to the costs of supporting a disabled or dependent mother or father or grandparent. While the new income rules require the monthly Social Security or disability income check to be included in the income computations, the expense rules fail to automatically include any funds for the necessary upkeep and support for this type of dependent. Finally, the failure of the IRS expense rules to deal with such things as day care expenses demonstrate the general problems created by this approach.

Page 314 PREV PAGE TOP OF DOC

The income formula is troublesome because it fails to take into account the problems of a debtor who has suffered a recent and dramatic loss of income due to unemployment, health, or other similar circumstances. It is well established that many debtors are finally forced into bankruptcy due to these and similar factors. Also, many widows and widowers are forced into bankruptcy shortly after the death of a spouse and the resultant loss of income. Yet, this budget approach strictly defines income as all income received from any and all sources within 180 days before filing and hence would preclude persons suffering from a drastic loss of income from filing.

The new sanction rules for abusive Chapter 7 filings and for abusive motions to dismiss or convert are simply not equivalent. The rules impose a substantially higher standard on the debtor and his attorney. To require the attorney to attest under oath to the accuracy of the information provided by his client creates an impossible situation that will cause significant problems, especially for the most honest, diligent and ethical attorneys—those whose efforts currently keep abusive practices by debtors to a minimum.

6. Section 124. Restraining Abusive Purchases on Secured Credit.

Legislative Changes

Contrary to the title, this provision is best described as the "anti-claim bifurcation rule." It amends §506 of the current Bankruptcy Code by adding §506(e) which in §506(e)(1) provides that in a Chapter 7, 11, 12 or 13 case the normal §506(a) valuation rules do not apply to any claim, in whole or in part, if it arose out of the purchase of personal property within 5 years of the filing date. Code section 506(e)(2) provides that if the 5 year purchase is secured only by the personal property so acquired, the amount of the allowed secured claim shall be the "sum of the unpaid principal balance of the purchase price and accrued and unpaid interest and charges at the contract rate. Code section 506(e)(3) provides that if the 5 year purchase is secured by the personal property so acquired and *other property*, then the §506(a) valuation rule applies but the amount of the secured claim shall not be less than the unpaid principal balance owed on the 5 year property plus unpaid interest and charges at the contract rate. Code section 506(e)(4) provides that if a second case is filed by or against the debtor within 2 years of the filing date of the first case then the secured value of all personal property shall not be less than the amounts provided in subsections (2) and (3) above.

Page 315 PREV PAGE TOP OF DOC

Practical Analysis of Provisions

By enacting a flat prohibition against the bifurcation of purchase money claims 5 years old or less, section 124 will remove a major incentive for debtors to choose Chapter 13 over Chapter 7. The new rules in effect create two classes of secured personal property debt: 5 year purchase money secured debt and any other secured debt. With respect to any security agreement related only to personal property acquired within 5 years of the petition date, the value must the "sum of the unpaid principal balance" plus all "accrued and unpaid interest and charges at the contract rate." If the security agreement includes purchase money 5 year property and other property (i.e., a refinance), then the valuation of all of the property may not be less than the unpaid principal balanced on the 5 year property "plus unpaid interest and charges at the contract rate."

This new claim bifurcation rule will severely limit the value of Chapter 13 for any consumer who has purchased any new property within 18 to 24 months of the filing date. Since high-end consumer finance agreements range from 60 to 72 months, the benefits of a 60 month Chapter 13 plan that requires payment of the full debt (plus all later charges) are not substantial. And, for the low-income consumer who may be paying a contract interest rate of 20 percent to 40 percent the benefits of a Chapter 13 plan are further reduced if not eliminated. The anti-claim bifurcation rule raises serious problems with respect to personal property that may be defective, damaged, or otherwise not in prime condition. The rule includes no provision for any reduction in value for these matters. This may leave many consumers with no option but to abandon such property as a part of their Chapter 13 plan. The 5 year anti-claim bifurcation rule will also cause many debtors with income below the National Median level to choose Chapter 7 over Chapter 13 because this section takes away their ability to keep personal property with monthly payments they can afford.

Page 316 PREV PAGE TOP OF DOC

The enactment of the new rules against claim bifurcation will work to the disadvantage of many *creditors* in Chapter 13, as well. A prohibition against the bifurcation of accounts representing older credit purchases will result in the creation of some secured claims the amount of which will likely substantially exceed the fair market replacement value of their collateral. As a result, the Section will discriminate against other secured creditors by reducing the pro-rata portion of the Chapter 13 plan payment that will be available for the payment of their claims, thus extending the time period necessary to pay the value of their properly-valued secured claims. In addition, unsecured creditors will see their percentage dividend reduced by the pro-rata portion of the plan payments that must be applied toward payment of the artificially high portion of the secured claim.

I suggest replacing section 124 of H.R. 833 with a provision that prohibits bifurcation of any secured claim to the extent that the claim represents a purchase money credit transaction incurred within 180 days of the bankruptcy filing date. This would represent a reasonable time period to protect secured creditors against abusive credit purchases in contemplation of bankruptcy.

By case law in the Western District of North Carolina, the bankruptcy court has created its own anti-claim bifurcation in Chapter 13 cases for personal property purchased within 180 days of bankruptcy filing. This case law has worked well to prevent "abusive" filings involving recent purchases.

7. Section 137. Adequate Protection of Lessors and Purchase Money Secured Creditors.

Page 317 PREV PAGE TOP OF DOC

Legislative Changes

Section 137 amends §1307 of the Code to add §1307A(a)(1)(A) which provides that adequate protection for Chapter 13 purposes means that on or before the end of 30 days from the filing date the debtor shall make direct cash payments to any lessor or personal property and any purchase money claim secured by personal property at the contract amount. Code section 1307A(a)(1)(B) provides that the debtor or the plan shall continue making the adequate protection contract cash payments until the creditor begins receiving actual payments under the plan or the debtor relinquishes possession of the property to the creditor.

Code section 1307A(b)(1) provides that subject to the limitations in (b)(2), the court may, after notice and hearing, change the amount or timing of the dates of adequate protection cash payment or payments to these creditors. However, 1307A(b)(2)(A) provides that the adequate protection cash payments shall be payable not less frequently than monthly and that the court may not limit this time period. Absent the filing of a motion to change the timing of these payments, 1307A(b)(2)(B) provides that the adequate protection cash payments shall not be less than the amount of any weekly, biweekly, monthly, or other periodic payment as determined and scheduled under the contract between the debtor and creditor.

Code section 1307A(c) provides that the adequate protection cash payments shall be continued in addition to plan payments under a confirmed plan until actual payments to the secured creditors begin under the plan if the plan provides for payments to these creditors *and* for the deferral of payments to such creditors or lessors under the plan pending the payment of any amounts as described in section 1326(b). Code section 1326(b) provides that before or at the time of each payment to creditors under the plan there shall be paid all unpaid administrative claims (legal fees under 507) and the percentage fixed for the Chapter 13 trustee.

Page 318 PREV PAGE TOP OF DOC

Code section 1307A(d) provides that a lessor or purchase money secured creditor may retain possession of property obtained under state law before the filing date until the first adequate protection cash payment is actually received. Such action does not violate Code sections 362, 542 or 543 of the code.

Practical Analysis of Provisions

The intent of this section is to correct that problem whereby secured creditors or lessors in some parts of the country do not receive periodic cash payments from the debtor or the Chapter 13 trustee to offset the continuing depreciation in the value of their collateral for a substantial period of time after the case filing date. While the concern is valid, the solution proposed in this section would not be financially possible for most Chapter 13 debtors.

As proposed, this section would in effect require the debtor to make *double* payments on secured claims and leases pending plan confirmation and the commencement of trustee distribution sot creditors. That is, the debtor would have to make the direct adequate protection payments to secured creditors and lessors, as required by this section, *and* begin to make proposed plan payments to the trustee as required by the Bankruptcy Code *at the same time*. For individuals who are already in financial distress, this will simply be impossible. And with the related provisions in H.R. 833 that will act to lengthen the time between case filing and plan confirmation, a bad situation will become worse.

It is important to note that the bankruptcy court and the Chapter 13 trustee, acting pursuant to the Code—and not the debtors—control the timing of plan confirmation and the commencement of plan distributions to creditors.

Page 319 PREV PAGE TOP OF DOC

I believe that an equally effective and substantially less financially burdensome solution to the concern of secured creditors and lessors would be to require the Chapter 13 debtor to begin escrowing plan payments with the trustee as of the case filing date. The trustee would then be authorized, pursuant to the statute, to begin making monthly adequate protection payments to creditors within thirty days of the case filing date. This would ensure a prompt commencement of adequate protection payments to creditors and eliminate the "double payment" problem faced by Chapter 13 debtors.

The amount of the payments should be at least the amount of the monthly depreciation of the personal property. In fact, the trustee can calculate the amount of the plan payment based upon the plan as proposed and the first payment at filing, so that the amount of payment to be received by the creditor under the plan can be the amount that is initially paid, and is the amount that continues throughout the life of the plan.

This suggested solution would also be responsive to the problem of pre-bankruptcy filing repossessions of secured or leased property. By requiring the escrow of the first plan payment by the debtor with the trustee on the case filing date, and confirmation of receipt to all affected parties, the creditor can safely return possession of the repossessed property with assurance of the prompt commencement of adequate protection payments by the trustee.

8. Section 117. Automatic Stay.

Legislative Changes

Page 320 PREV PAGE TOP OF DOC

This provision amends §362(h) to eliminate possible recovery of punitive damages for any willful violation of the automatic stay and to preclude bringing an action for a stay violation as a class action. Under H.R. 833 individuals injured by willful violations of the stay are entitled to recover only actual damages and costs, including attorney's fees. Also, section 117 of H.R. 833 adds §362(i)(2) which provides that if a creditor took action in a good faith belief that the stay did not apply, the recovery is limited to actual damages.

Practical Analysis of Provisions

This change will not be a strong enough deterrent to willful violations of the stay by creditors. Without the threat of possible punitive damages or possible class action lawsuits, many creditors may make an economic decision that it is cheaper to risk that its employee may violate the stay than it is to maintain the safeguards necessary to prevent the stay violation. This is a very ill-advised provision.

9. Section 116. Effect of Discharge.

Legislative Changes

The addition by section 116 of H.R. 833 of subsection (i) to §524 is a positive change. But, section 116 also adds subsection (j) to §524 which allows only the greater of actual damages or $1,000 plus costs and attorneys fees for any willful violation of the discharge injunction and also class actions for discharge injunction violations are precluded.

Page 321 PREV PAGE TOP OF DOC

Practical Analysis of Provisions

As with the automatic stay provisions discussed above, this provision would not act as a sufficient deterrent to willful violations of the discharge injunction by creditors. As recent headlines have confirmed, the risk of violation of the discharge injunction by corporate commercial interests is very real. The elimination of punitive damage and class action remedy options would only serve to encourage such violation in the future.

10. Section 129. Discharge under Chapter 13.

Legislative Changes

This provision expands the exceptions for the Chapter 13 discharge and amends §1328(a) by adding matters currently excepted from Chapter 7 discharge under §523(a)(2), (3)(B), and (4).

Practical Analysis of Provision

This provision also reduces the incentives for a debtor to choose Chapter 13 over Chapter 7 with the addition of subsection (a)(2) exception to a Chapter 13 discharge there will probably be a significant increase in litigation in Chapter 13 cases. As illustrated by the *In re Stahl* case, a copy of which is attached hereto, notwithstanding the provisions of §523(d) which subjects creditors to possible sanctions for prosecuting challenges to dischargeability which are not substantially justified. As the Stahl case shows, these creditors "play the odds" that the debtor's attorney will not fight back and thus use the discharge complaint as a way to force a reaffirmation of the debt. If section 129 of H.R. 833 is enacted, fact situations like that stated in In re Stahl will be commonplace and litigation in Chapter 13 cases will increase significantly. Opening the door in Chapter 13 cases only encourages this behavior on the part of some unscrupulous creditors.

Page 322 PREV PAGE TOP OF DOC

11. Section 603. Fair Notice in Chapter 7 and Chapter 13

Legislative Changes

Section 603 of H.R. 833 expands §342 by adding §342(c) which provides that the debtor shall include the account number and any designated address for any creditor on any notice required by the Code. Code section 342(d) provides that at any time after commencement of the case a creditor may serve on the debtor a notice of address to be used for the creditor and 5 days after receipt such address must be used on all future notices. The rule further provides if the debtor lists a governmental until he shall identify the department, agency or instrumentality thorough which the debtor is indebted and identify the basis for the claim with all appropriate account or identification numbers. Code section 342(e) provides that any creditor may file an address notice with the court for all Chapter 7 and Chapter 13 cases and 30 days after such filing all such notices given by the court (and perhaps by the debtor) must be to that address. This rule also provides that any governmental unit may file a "safe harbor" mailing address for service of notices in cases pending in the district and the Clerk shall make this list available to all debtors.

Section 603 of H.R. 833 also added §342(f) which provides that notice given to a creditor other than provided in this section shall not be effective notice until it has been brought to the attention of the creditor. Furthermore, if a creditor has designated a person or a department to be responsible for receiving notices concerning bankruptcy cases and has established reasonable procedures so that bankruptcy notices received by the creditor will be delivered to such department or person, notice will not be brought to the attention of the creditor until received by such person or department. No sanction under Code section 362(h) of this title or any other sanction which a court may impose on account of violations of the stay under §362(a) of this title or failure to comply with §542 or §543 of this title may be imposed on any action of the creditor unless the action takes place after the creditor has received notice of the commencement of the case effective under this section. As to a governmental unit, a notice that fails to comply with these rules shall not be effective unless the debtor demonstrates, by clear and convincing evidence, that timely notice was given in a manner reasonably calculated to satisfy the requirements of this section and that either the notice was timely sent to the safe harbor address or no safe harbor address was provided and that an officer of the governmental unit who is responsible for the matter or claim had actual knowledge of the case in sufficient time to act.

Page 323 PREV PAGE TOP OF DOC

Practical Analysis of Provisions

The new notice and automatic stay violations rule appear to create a new defense so long as the creditor does not provide the debtor with any "bankruptcy notice" address on its bills and statements and does not file a master address with the clerk. This is the case because if a debtor cannot give a creditor notice at such an address then in order to successfully prosecute a stay or discharge violation the debtor must prove that the offensive action was taken *after* the bankruptcy department of the creditor actually received the bankruptcy notice. On the other hand, this same section gives every creditor a new defense to this type of motion: We have established a bankruptcy unit and have established reasonable internal procedures for processing bankruptcy notices.

If a governmental unit fails to give a "safe harbor" address to the clerk, then in order to prove a stay or discharge violation the debtor must establish by "clear and convincing evidence" that timely notice was given and that the responsible governmental unit had actual knowledge of the bankruptcy case. Here again, the new rule creates good reasons for not filing "safe harbor" addresses.

The combination of damage limitations, notice requirements, defenses, and sanctions will certainly "chill" the rights of many debtors who seek to enforce bankruptcy stays and discharge injunctions. It is also clear that absent a "safe" "safe harbor" address any debtor's attorney must make a "good faith" effort to confirm actual notice and knowledge of the case before pursuing any bankruptcy violations.

Page 324 PREV PAGE TOP OF DOC

12. Section 603(b). Debtor Duties.

Legislative Changes

Section 603(b) of H.R. 833 amends §521, requiring debtors to file additional documents including:

1. Copies of any Federal tax returns for 3 years prior to filing (including schedules, etc);

2. Copies of all payments from any employer received in the 60 days before the filing;

3. A statement of the amount of projected monthly net income, itemized to show how calculated; and

4. A statement disclosing any reasonably anticipated increases in income or expenditures for 12 months post filing.

Section 603 of H.R. 833 adds to 11 U.S.C. §521, subsection (f) which provides that a debtor in a Chapter 7 or 13 case shall file with the court any tax returns that become due until the case is *closed*, any returns not filed at the petition date for up to 3 years prior to filing date (as they are filed with the taxing authority), and any amendments to any filed tax returns, whether or not related to pre or post petition returns. In the case of a Chapter 13 debtor, an annual statement of income and expenses must also be filed for the preceding tax year. The statement must clearly show how the amounts were calculated.

Page 325 PREV PAGE TOP OF DOC

Section 603 of H.R. 833 adds subsection (b) to 11 U.S.C. §521. Code section 521(b)(1) provides that in a Chapter 7 or 13 case the failure of the debtor to file all of the (a)(1) documents within 45 days after the petition shall result in the automatic dismissal of the case on the 46th day after filing. Code section 521(b)(2) provides that any party in interest may request the court to dismiss a Chapter 7 or 13 case under §521(b)(1) and the court must, if so requested, enter an order of dismissal not later than 5 days after such a request. Code section 521(b)(3) provides that upon request of the debtor and for good cause made within the first 45 days from the filing date the court may allow the debtor an additional period not to exceed 45 days to file the (a)(1) documentation.

Practical Analysis of Provisions

The income tax requirement raises troublesome issues about privacy rights and the disclosure of confidential information related to every Chapter 7 and 13 debtor. Although the statute authorizes a "study" to review how to safeguard the information in these returns, the filing requirement is not delayed pending the study. Moreover, 11 U.S.C. §521(g)(1), which is added by section 603 of H.R. 833, does not require any safeguards as to the filing of tax returns until 30 days after cases are filed in which returns are due under this Act.

The tax filing rule also creates a problem for many low-income debtors who simply do not keep any records of their prior returns. The penalty for non-filing is very harsh—automatic dismissal on the 46th day with no extension except for good cause. And, the extension is somewhat illusory. Debtors who do not maintain copies of their tax returns will be required to request copies from the Internal Revenue Service. Receipt of such returns from the Internal Revenue Service within 45 days of the request is unheard of. Within 90 days is unlikely. Additionally, delaying the first meeting of creditors in a Chapter 13 case will be burdensome if not impossible for Chapter 13 debtors who are required to continue making contract payments on most secured debts pending "distribution of payments under the plan."

Page 326 PREV PAGE TOP OF DOC

Finally, this requirement creates a problem for any debtor filing between January 1st and April 15th of any calendar year. Under the rules, this debtor must file his current tax return before the first meeting of creditors. And, if such a return has not been filed then the first meeting is continued until the return April 15 or any automatic extension date. The problem with this rule relates to the adequate protection cash payments to secured creditors that the Chapter 13 debtor must make pending plan distributions to these creditors. For these debtors, a 4 to 6 month delay in the first meeting is simply not feasible.

As a Chapter 7 panel trustee, in the vast majority of cases it is not necessary to review a debtor's tax returns. In cases where it is necessary, the trustee or other party in interest need only request them pursuant to Federal Rule of Bankruptcy Procedure 2004. Moreover, debtors are required pursuant to §521(3) and §521(4), and may have their discharge denied for failure to meet these duties. The current provisions are sufficient to enable trustees, United States trustees, bankruptcy administrators and other parties in interest to protect their interests and the integrity of the bankruptcy system.

13. Section 302. Miscellaneous Improvements.

Legislative Changes

Section 302 of H.R. 833 adds §109(h)(1) which provides that notwithstanding any other provision of the Code an individual may not be a debtor under Title 11 unless during the 90 day period before the date of filing the individual has received credit counseling, including, at a minimum, participation in an individual or group briefing that outlined the opportunities for available credit counseling and assisted that individual in performing an initial budget analysis.

Page 327 PREV PAGE TOP OF DOC

Code section 109(h)(2)(A) provides that (h)(1) does not apply if the United States Trustee or Bankruptcy Administrator for the district determines that the credit counseling services in that district are not reasonably able to provide adequate services. Code section 109(h)(2)(B) provides that these certification decisions shall be reviewed on an annual basis. In other words, the application of the rule to any district must be determined and re-determined on an annual basis.

Code section 109(h)(3)(A) provides that the 90 day debt counseling rule shall not apply to a debtor who submits to the court a certification that:

1. describes exigent circumstances that merit the waiver;

2. states that the debtor requested credit counseling services from an approved counseling service, but was unable to obtain the services during the 5 day period beginning on the date on which the debtor made the request; and

3. is satisfactory to the court.

Code section 109(h)(3)(B) provides that the exemption from debt counseling upon a showing of exigent circumstances "shall cease to apply to that debtor on the date on which the debtor meets the requirements of paragraph (1), but in no case may the exemption apply to that debtor after the date that is 30 days after the debtor files a petition."

Practical Analysis of Provisions

Page 328 PREV PAGE TOP OF DOC

The irony of the "credit counseling" rule is that it probably will not apply at all in many rural districts. It is not clear, however, if the "finding of inadequate services" by the Trustee or the Bankruptcy Administrator is limited to the entire "judicial district" or to "divisions" within the district. For example, the Western District of North Carolina is divided into the Charlotte, Statesville, Shelby, Asheville and Bryson City divisions. It is certainly likely that an "inadequate services" finding would apply to the Shelby Division but not to the Charlotte division. The same argument could be made for individuals residing in rural counties within each judicial division. The standard of not "reasonably able to provide adequate services to individuals" is very vague and subject to many different interpretations.

The Act also seems to require any debtor who files under "exigent circumstances" in an approved district or division to secure "credit counseling" within 30 days of the petition date. If such counseling was not secured, then it appears that the case would be subject to a motion to dismiss on the grounds that the individual was no longer "a debtor" under Code section 109. What the debtor must do in this situation, what the debtor must file with the court in the form of a certification, or who may move to dismiss is not covered by this amendment.

It is also not clear how these post-filing credit services would benefit an individual who was already a debtor under Chapter 13. Perhaps the only possible benefit would be the additional leverage the Chapter 13 filing might bring on unsecured creditors to accept a voluntary repayment plan. For example, Code section 502 has been amended to allow a debtor to file a motion to reduce an unsecured consumer claim by not more than 20% if the debtor can prove by "clear and convincing" evidence that the claim was filed by a creditor who unreasonably refused to negotiate a alternative repayment schedule approved by an approved credit counseling agency. However, this same section provides that the repayment schedule must have been offered "at least 60 days before the filing of the petition", had to offer to repay at least 60 percent of the loan during the original loan term, and provided that no part of the debt to be repaid would be non-dischargeable in a bankruptcy case.

Page 329 PREV PAGE TOP OF DOC

The Chapter 13 discharge rules, supra, have been amended to provide that a debtor is not entitled to the discharge unless the debtor has completed an instructional course concerning personal financial management (assuming such a course has been approved in the district).

14. Section 126. Exemptions.

Legislative Changes

Section 126 of H.R.833 amends §522(b)(2)(A) to provide that a debtor may claim State or local exemptions on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 730 days (2 years) immediately preceding the date of the filing of the petition. The old 180 rule is therefore deleted as is the provision that would allow a debtor to claim exemptions where the debtor had been domiciled for a greater part of the old 180 day period.

Code section 522(n) provides that the amount of value a debtor may exempt in real or personal property that the debtor or a dependent of the debtor uses as a residence, a cooperative or a burial plot shall be reduced to the extent the value is attributable to any property the debtor disposed of within the 730 day period with the intent to hinder, delay or defraud a creditor which the debtor could not have exempted on the filing date.

Code section 522(f)(1)(B)(ii) provides that household goods shall mean clothing; furniture; appliances; one radio; one television; one VCR; linens; china; crockery; kitchenware; education materials and educational equipment primarily for the use of minor dependent children of the debtor, but only one personal computer and only if used primarily for the education or entertainment of such minor children; medical equipment and supplies; furniture exclusively for the use of minor children, elderly or other dependents of the debtor; and personal effects (including wedding rings and the toys and hobby equipment of minor dependent children) of the debtor and his or her dependents: Provided, That the following are not included within the scope of the term "household goods":

Page 330 PREV PAGE TOP OF DOC

(aa) works of art (unless by or of the debtor or his or her dependents);

(bb) electronic entertainment equipment (except one television, one radio, and one VCR);

(cc) items acquired as antiques;

(dd) jewelry (except wedding rings);

(ee) a computer (except as otherwise provided in this section), motor vehicle (including a tractor or lawn tractor), boat, or a motorized recreational device, conveyance, vehicle, watercraft, or aircraft.

Code section 522(b) also provides that any funds placed in an Educational IRA account at least 365 days before filing and which has not been pledged or promised to any person in connection with credit is exempt. However, this same section then provides that such accounts shall not be exempt:

1. Unless the debtor has one or more dependent children less than 22 years of age;

2. If the amounts in the IRA are not less than $50,000.00 per each dependent and not more than $100,000.00 for all such dependents;

3. To the extent the contributions to the fund exceed the sum of $500.00 per year per child; and

Page 331 PREV PAGE TOP OF DOC

4. To the extent any person has any ownership rights or control of the fund other than the dependent child or children of the debtor to whom such account is attributable.

Practical Analysis of Provisions

The new exemption rules appear to create what may be called a "debtor without a state" or a debtor "without any exemptions." The problem is created by the requirement that the debtor may only claim exemptions on the filing date "at the place in which the debtor's domicile has been located for the 730 days immediately preceding the date of the filing of the petition." The statute does not say for the "greater part of the last 730 days" but for the last 730 days. This leaves in doubt what happens to the debtor who just moved to a State 18 months before the filing date. This debtor would not be able to claim the exemptions in his new state or in his old state. Would this debtor then be limited to the federal exemptions? Would the debtor have no exemptions? The rule is simply not clear on these issues.

The new exemption rules also impose a highly restrictive definition on household goods. Generally speaking, works of art, electronic equipment (other than 1 t.v., 1 vcr, and 1 radio), items purchased as antiques, jewelry (other than wedding rings), a computer, motor vehicle, riding lawn mower, motorcycle, boat, camper, and aircrafts are excluded from the definition. The definition is therefore limited to such things as clothing, furniture, appliances, 1 radio, 1 television, 1 VCR, linens, china, crockery, kitchenware, and furniture and educational materials for dependents. The definition of household goods would clearly pre-empt state exemptions statues as to the type of goods but the valuation issues would still be subject to state limitations. This would only serve to give leverage to the sub-prime, non-possessory, non-purchase money lenders in household goods who use the household goods merely as a threat.

Page 332 PREV PAGE TOP OF DOC

The Education IRA account may only come into play for a Chapter 7 or 13 case filed after the year 2020. Simply stated, it would take that long for any debtor to build up a fund of not less than $50,000.00 nor more than $100,000.00 with contributions of not more than $500.00 per year per child. Furthermore, the application of the annual contribution is unclear since it fails to account into account any appreciation in the account or to what extent the exemption may still apply if the annual contributions exceeded $500.00 per child. And, if the value of the account was $49,999.99 on the date of the filing then none of the IRA would be exempt regardless of the number of dependent children. Likewise, if the account was $100,000.99 on the date of filing then no part of the IRA would be exempt.

15. Section 605. Adequate Time to Prepare for Hearing on Confirmation of the Plan.

Legislative Changes

Section 605 of H.R. 833 amends §1321 to provide that the debtor shall file a plan not later than 90 days after the filing of the petition. The court may extend such period if it is the result of circumstances to which debtor should not justly be held accountable.

Code section 1322(d) provides that if the total income for the filing unit is not less than the highest national median family income reported for a family unit of the same size, the plan may not provide for payments over a period that is longer than 5 years. If the total income for the filing unit is less than this amount, the plan may not provide for payments over a period that is longer than 3 years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than 5 years.

Page 333 PREV PAGE TOP OF DOC

Code section 1329(c) then provides that the duration of a plan shall be for a period of at least 5 years if the current total monthly income for the filing unit is not less than highest national median family income for the same size family unit, as of the date of modification and shall be at least 3 years if the said income is less than the national median.

Code section 1325(a)(8) provides that in order to confirm the plan the debtor must have filed all Federal, State and local tax returns as required by §1308. Code section 1308(a) provides that at least one day before the 341 meeting the debtor shall have filed all tax returns for periods ending 3 years before the date of the filing. Code section 1308(b) provides that if such returns have not been filed at least one day before the 341 meeting, the trustee may continue the meeting for a reasonable time but in no event for more than 120 days for past due returns and for returns not past due the meeting may be continued until the later of 120 days from such date or the due date for such returns under the last automatic extension of time for filing and for which such a request has been timely made by the debtor. Code section 1307(e) provides that upon failure of the debtor to file such tax returns and on request of a party in interest the court shall dismiss a case or convert the case to Chapter 7, whichever is in the best interest of creditors.

Practical Analysis of Provisions

All plans must be for at least 5 years in duration if the current total monthly income for the filing unit is not less than the highest national median income for the same size family unit. Otherwise, the plan may not exceed 3 years unless the court allows a longer period. The same 5 year rule applies to any Chapter 13 plan modification. The 5 year rule is somewhat illusory since the anti-claim bifurcation and valuation rules will require almost all plans to run for 60 months just from a feasibility point of view.

Page 334 PREV PAGE TOP OF DOC

The debtor must also prove that all pre and post filing tax returns have been filed as a condition of confirmation. Such returns must also have been filed before the first meeting. As a result, the confirmation provision on taxes will have little or no relevance in almost every Chapter 13 case. The real problem with tax returns relates to the prior year returns that become due for all cases filed between 01 January and 15 April of any calendar year. In order to avoid the direct adequate protection cash payments and a mandatory delay of the first meeting, all debtor may be required to file such returns with their petition. This could create yet another roadblock to filings under exigent circumstances and cause many attorneys to decline representation in any such cases.

16. Section 302. Miscellaneous Improvements.

Legislative Changes

The definition of a residence is expanded to include a mobile home or a modular home or any similar structure.

Practical Analysis of Provisions

As a result, the debts secured by first mortgage liens on this type of property will not be subject to modification under Chapter 13. This property will be treated just like residential real estate under 1322(b)(2).

17. Sections 103, 105, 106, 107 and 108. Debtor Protections.

Page 335 PREV PAGE TOP OF DOC

Legislative Changes

Code section 342(b) provides that prior to the commencement of a consumer bankruptcy case the debtor must be provided with an approved written notice of Chapters 7, 11, 12 and 13 and the general purpose, benefits, and costs of proceeding under each of those chapters. The section then goes on to provide that this notice must also include a brief description of services that my be available to the debtor from a "credit counseling service that is approved by the

United States trustee for that district."

Code section 101 is amended to create the following new terms: an assisted person, bankruptcy assistance, and a debt relief agency. An assisted person is any person whose debts consist primarily of consumer debts and whose non-exempt assets are less than $150,000.00. Bankruptcy assistance means doing anything for any type of fee to provide an assisted person with bankruptcy advise or help including the providing of legal representation under Title 11. A debt relief agency is any person who provides any bankruptcy assistance to any assisted person in return for the payment of money or other valuable consideration or a bankruptcy petition preparer. Non-profit organizations, creditors, or any FDIC bank or any affiliate or subsidiary of such a bank are specifically excluded from this definition.

The rule then creates three separate disclosures that must be given by any debt relief agency. These disclosures are in addition to the 342(b) disclosure. The new disclosures are provided for by Rules 526(a), 526(b) and 526(c). The 526(a) disclosure must be given within 3 business days after the first date of any bankruptcy assistance. The rule basically includes all information that the assisted person must provide in connection with the bankruptcy filing and warns these parties of the new audit procedures. The notice specifically provides that "failure to provide such information may result in dismissal of the proceeding under this title or other sanction including, in some instances, criminal sanctions."

Page 336 PREV PAGE TOP OF DOC

The 526(b) disclosure informs the assisted person that he may represent himself in a bankruptcy case or hire an attorney or a bankruptcy petition preparer. The notice also includes information about the requirement of a written contract specifying what the attorney or petition preparer will do for the debtor and how much it will cost. The form includes many statements about bankruptcy relief including the following: "Although bankruptcy can be complex, many cases are routine."

Code section 526(c) provides that a debt relief agency shall provide the assisted person at the time of the initial (a) and (b) notices "reasonably sufficient information" either orally or in clear and conspicuous writing on how to provide all of the information required to commence a bankruptcy case including:

1. How to value assets at replacement value, determine current monthly income, projected monthly income and, in a Chapter 13 case, net month income, and related calculations;

2. How to complete the list of creditors, including how to determine what amount is owed and what address for the creditor should be shown; and

3. How to determine what property is exempt and how to value exempt property at replacement value as defined under Code section 506 of this title.

A debt relief agency must retain signed copies of these notices for two years after the later of the date on which the notice is given the assisted person.

Page 337 PREV PAGE TOP OF DOC

Code section 527(a)(1) provides that within 5 business days after a debt relief agency provides any bankruptcy services to an assisted person that parties must execute a written contract. The contract must specify "clearly and conspicuously" the services to be provided and the basis on which fees or charges will be made and the terms of payment. Any contract that fails to fully comply with these rules is "void" and may "not be enforced by an Federal or State court or any other person" under Code section 528(a). In addition, 528(b) provides for serious sanctions for failure to comply with the rules, the contract, or for any negligence or intentional disregard of any of the bankruptcy rules. The remedies include liability for all fees and charges to the assisted person, actual damages to the assisted person, injunctive relief, and other civil penalties. Code section 527(a)(2) provides that a debt relief agency shall disclose the following on any advertisement related to bankruptcy: WE ARE A DEBT RELIEF AGENCY. WE HELP

PEOPLE FILE BANKRUPTCY PETITIONS TO OBTAIN RELIEF UNDER THE BANKRUPTCY CODE.

Practical Analysis of Provisions

The practical effect of these new notice rules will be to discourage debtors from using attorneys to represent them in bankruptcy cases. Encouraging pro se filings by debtors will increase the administrative costs of operating the bankruptcy system and will prejudice the substantive rights of all parties.

The requirement to "fully and completely" explain the "ins and outs" of how to file a consumer bankruptcy case are extremely burdensome. Due to the complexity of the legislation, it is simply too risky to rely on a written document for this information and certainly much too dangerous to rely on what at best would be an inconsistent oral presentation.

Page 338 PREV PAGE TOP OF DOC

CLOSING COMMENTS

The credit industry cites the large number of consumer bankruptcy filings and the perceived abuse in a large number of Chapter 7 cases as a reason for "bankruptcy reform." The anomaly the current political discourse is that all of the debate has been focused on the stated purpose of reforming or denying Chapter 7 relief to the majority of debtors and forcing these same debtors into Chapter 13 repayment plans. It is hard to argue against the proposition that everyone should pay their debts to the extent they have the ability to do so. The problem with H.R. 833 is that it creates financial, procedural and jurisdictional barriers to Chapter 13 relief for the majority of debtors who really need relief.

The objective evidence does not support any factual finding of present or a pending bankruptcy crisis or of the need for massive consumer bankruptcy reform. For example, Daniel Mica, President of the Credit Union National Association, said at a meeting in September of 1997 that "when it comes to blame, there's enough to go around, both consumers and financial institutions." Mr. Mica's common-sense observations have been documented by several studies including one by the Hon. Joe Lee, a distinguished bankruptcy judge in Lexington, Kentucky. Using Federal Reserve data, Judge Lee found a direct and irrefutable relationship between the number of consumer bankruptcy filings since 1977 and the amount of outstanding consumer credit. Specifically, in 1977 there were .74 consumer bankruptcy filings for every million dollars in consumer credit; and, in 1997 there were .73 consumer bankruptcy filings for every million dollars of consumer credit.

Judge Lee's detailed, learned and highly documented observations are supported by more complex studies. After a comprehensive analysis, the Congressional Budget Office told Congress in April of 1997 that "nonbusiness bankruptcy filings move with measures of household indebtedness." In another detailed statistical study, economists Jagdeep Bhandari and Lawrence Weiss reached a similar conclusion. Specifically, they stated to the National Conference of Bankruptcy Judges that "our evidence indicates that the increase in the number of bankruptcy filings is primarily due to the increased level of debt as a percentage of income." Finally, economist Lawrence Ausubel, focusing particularly on credit card debt, noted that the rate of consumer bankruptcy filings is "astonishingly highly correlated with the rise in credit card defaults."

Page 339 PREV PAGE TOP OF DOC

No one would argue that some level of reform would be helpful and that some abusive practices should be eliminated. However, before we throw out the baby with the bath water everyone needs to take a deep breath and a long second look at what we are about to do. The reason that our bankruptcy system has always worked so well is that it is balanced. Before we un-level the playing field we need to thoroughly examine the full impact of the proposed changes—not just on the credit industry, but on the ability of families to provide for their children, on whether entrepreneurial endeavors are discouraged and the health of the entire consumer-oriented economy. Indeed, these proposed changes may have far-reaching effects on our economy which could prove disastrous, even to the credit industry.

Mr. Sigmon gratefully acknowledges the assistance of the following in the preparation of this statement: O. Max Gardner, III, a bankruptcy practitioner in Shelby, North Carolina; Warren L. Tadlock, the Chapter 13 trustee for the Charlotte Division of the Western District of North Carolina; and Linda W. Simpson, Bankruptcy Administrator for the Western District of North Carolina.

Mr. **BRYANT.** I thank the entire panel. You quickly gained that ability that we have in Congress to squeeze 10 minutes into 5 minutes very effectively. I want to congratulate all of you.

At this point, the chair would recognize our distinguished colleague from New York, Mr. Nadler.

Mr. **NADLER.** Thank you.

Page 340 PREV PAGE TOP OF DOC

I would like to ask first Professor Klee and then Mr. Sigmon, could you give us practical examples of how this bill would function to undermine the rights of honest but unfortunate debtors? The traps I think you mentioned were in this bill.

Someone said the other day there are 20 pages of this bill on these needs-based bankruptcies that are getting all the attention of 300 pages and everything else. Every one of those 300 pages is something that further tilts the playing field against the debtor.

So, Professor Klee, could you give us a number of examples in your opinion of unfair provisions that would undermine the rights of honest but unfortunate debtors and also of provisions that would allow wealthy, well-advised debtors to avoid their obligations in bankruptcy?

Mr. **KLEE.** That is quite a question, Congressman Nadler. There are so many provisions in the bill that we have dealt with in our written testimony that I will try to highlight a few for you.

First, I just gave a numerical example during my oral testimony that I think shows the way section 102 is written that you could have low-income debtors excluded from chapter 7. $18,000 a year in income is certainly low-income, with $7,200 in credit card debit. And if they could afford to pay $30 a month to their unsecured creditors, they would be deemed to have "abused" chapter 7, yet they wouldn't be able to confirm a plan in chapter 13. They would be left outside of bankruptcy at the mercy of their creditors.

Page 341 PREV PAGE TOP OF DOC

They would either have to do preplanning to incur more debt and hope that the debt that they incur wouldn't be incurred by fraud or they would have to incur more expenses, and then they have the IRS collection standards to contend with. Or they would have to wait until the interest runs up on the debt so that they would be in a position where they couldn't pay 25 percent of their debt in order to file.

On the other hand, high-income people, if they go to lawyers and they have planning and they can either run up the debt or manipulate their ability to repay in such a way that they can't pay $5,000 in discretionary income or 25 percent of their debt, whichever is less, could file chapter 7 and get out of their debts. There is a safe harbor for certain kinds of debtors.

The court retains discretion to dismiss for totality of the circumstances, but I don't believe the factors are spelled out as well as they should be.

Reaffirmation is a huge issue. The goal of the credit industry here appears to me to be to keep debtors under an 18 percent or 20 percent interest burden for a long period of time. That is how they make their profits.

And, by the way, let me just say on the record I do think the extension of consumer credit is a good thing. I think it has driven the economy and that credit cards are a wonderful thing for Internet commerce and everything else. But it has been marketed on a volume basis, and everybody here knows that. Every Member of Congress has received credit card solicitations in the mail, just like we all have; and it can be marketed on a high-volume basis, because it is very high-profit lending.

Page 342 PREV PAGE TOP OF DOC

But high overall profits mean there are going to be high losses in some cases, and to the extent these debts are made nondischargeable and not affected by bankruptcy and more debtors are forced into chapter 13, the net on credit card competition can be cast even wider, which I think will lead to even more defaults and more bankruptcy filings.

Mr. **NADLER.** In other words, from what you just said, the credit card issuers are lending on an actuarial basis, which might be a good thing for the economy, but this bill would take away the safety net that that certainly necessitates?

Mr. **KLEE.** I think that is right.

Now, Mr. Moore is not lending on that type of basis. He is doing his credit checks, and he is looking at his customers, and he is having his customers either qualify or not qualify. But the larger credit card companies are lending on a different kind of basis, and their goal is to either have the debt nondischargeable—and there are increased provisions in this bill that provide for nondischargeability—or to have it reaffirmed.

And there should be no occasion under which unsecured debts should be reaffirmed—one of the things Mr. Wallace didn't mention that was in my article, when I did call for reform, and I still do, is a ban on reaffirmations for unsecured debt. A debtor can always repay discharged debts voluntarily.

Mr. **NADLER.** There should be or should not be such a ban, did you say?

Page 343 PREV PAGE TOP OF DOC

Mr. **KLEE.** Debtors should not be permitted to reaffirm and have a legally binding contract to pay an unsecured discharged debt. They can always voluntarily repay their discharged debts. And I would hope that some of Mr. Moore's customers will come to him and voluntarily repay their discharged debts.

Secured reaffirmation is a tougher question, though. Because where the collateral is the automobile or something that is important to the household, there the debtor probably would want to reaffirm, but the bill should not permit reaffirmation for more than the fair value of the item. That would give the creditor what it would get if it foreclosed and it gives the debtor the collateral to go forward. I think the reaffirmation of secured debt is important.

Mr. **NADLER.** Let me—with the indulgence of the chair, let me ask one other question before the red light gets really red.

You alluded to the elimination of the class action remedy under this bill. Presumably Sears could do it again and get away with it. Are there other ways in which this legislation would promote debtor coercion, even though they may not be subject to the means test? In other words, debtors who are not subject to the means test or below the means test, are there provisions in this bill that would promote coercion of those debtors for reaffirmation or other things?

Mr. **KLEE.** I believe so. Because the bill contains increased nondischargability provisions, many of which would be settled through reaffirmations. When creditors bring on suits or threaten nondischargeability litigation, many debtors can't afford to litigate. So what they do is settle on a reaffirmation. The creditor drops the suit. This bill opens the door to more opportunity for that kind of thing to happen.

Page 344 PREV PAGE TOP OF DOC

Mr. **NADLER.** So the coercive provision in this bill that allows for that is that the creditor can make a motion and coerce a reaffirmation?

Mr. **KLEE.** The creditor can move to have nondischargeability in a broader range of categories than under current law. And in settlement of that nondischargeability litigation, reaffirmations will result. We deal with this in our written testimony.

Mr. **NADLER.** Thank you, sir.

Mr. **GEKAS.** [Presiding.] Thank you, professor.

Also at this time the chair would recognize the gentleman from Ohio, Mr. Chabot.

Mr. **CHABOT.** Thank you, Mr. Chairman.

Professor Klee, you mentioned—I think you said 3 percent in your opinion abused the system of bankruptcy; is that correct? And I think, Mr. Wallace, I think you used a figure 10 to 20 percent. Could each of you address that briefly? Maybe starting with Professor Klee.

Mr. **KLEE.** There is a debate on the statistics, and you will have the privilege of having a panel here this morning, I believe the third panel, who will talk about the numbers.

Page 345 PREV PAGE TOP OF DOC

Different people look at different things to determine percentages of abuse. The question is, depending on the formula you take to define "abuse," you are going to have different percentages of people who could fit within that formula and deemed to have abused bankruptcy.

Even outside the formula, there are people who abuse bankruptcy. Some of the celebrity cases that were referred to are people who move and try to get a large homestead exemption, those are abuses.

Mr. **CHABOT.** I have got kind of limited time. Let me go over to Mr. Wallace.

Mr. **WALLACE.** Yes, there are different studies. They come out with different results. Let me stress that 3 percent still means 30,000 people a year. It is still a significant amount. It is estimated by the study that is referred to—that is the 3 percent study—as producing approximately $800 million a year that is not being paid back to creditors that could be. So even at 3 percent it is not a small amount.

We believe that study was improperly structured. I won't go into the details. You will hear more about that.

Mr. **CHABOT.** Let me go back to Professor Klee and Professor Zywicki.

Page 346 PREV PAGE TOP OF DOC

Another discrepancy I obviously heard is relative to debts driving bankruptcy or not. Professor Klee, you said they do; and, Professor Zywicki, you said they don't. Could you each address that just briefly also?

Mr. **ZYWICKI.** Well, what is sort of curious to me is how this even kind of caught on, because, literally, the argument seems to be draw two lines on a piece of paper. Sometimes, if you want to be really technical, you make them different colors; and then you say look, debt and bankruptcies are correlating.

Well, if one of my students brought this to me, I would say, go back and do more research. That is not an argument for causation, first.

Secondly, debt has worsened gradually. Bankruptcies are jumping 29 percent a year from 1995 to '96, 20 percent from 1996 to 1997. Consumer debt did not jump 29 and 20 percent those years.

Also, they asked the wrong question. The real question should be current indebtedness. Can you pay your bills as they come due? Well, current indebtedness burdens have fallen a lot in recent years because of the fall in interest rates. Because interest rates are so low, people should be able to pay their bills as they come due more often. And I am just not sure what some sort of balance sheet test of adding income and debt makes any sense.

Also, the ease of discharge, of course, is related to how much people will borrow. So let's say that debt causes bankruptcy is circular. Because the bankruptcy system will help determine how much people are willing to borrow, it seems fairly obvious.

Page 347 PREV PAGE TOP OF DOC

And, finally, there is no attempt when they draw these two lines to try to distinguish debt from just shear overspending, that a lot of this—people aren't buying debt. People are buying cars and trips and vacations and household furnishings, all of these sorts of things. How many times are people just consciously trying to maintain a life-style they can't afford, versus some sort of theory whereby, you know, they are getting debt sort of forced on them. So the model of debt causes bankruptcy isn't even a coherent model, I don't believe.

Mr. **CHABOT.** Thank you.

Professor Klee.

Mr. **KLEE.** Yes, Congressman Chabot. People without debt don't file for bankruptcy. And the question is, what causes the debt? The home mortgage or the rental obligation and the car loan, that is fairly standard stuff. Every now and then you get debts for medical expenses. But you do have credit card debts at the margin. They have increased dramatically.

The bankruptcy rate in the United States has soared in recent years, but it has also gone up in Canada. And Canada doesn't have our 1978 Bankruptcy Code to blame for that reason. They do, however, have the rise of consumer credit; and it is that credit at the margin that makes the difference in a debtor's ability to pay all creditors.

I don't think that the availability of a bankruptcy system actually encourages people to go out and incur debt. There are those few people who are abusers, but the great mass of people try to borrow responsibly. They just don't understand what it means to have a credit card with a minimum payment not even pay the accrued interest on the credit card.

Page 348 PREV PAGE TOP OF DOC

Mr. **CHABOT.** Thank you.

Let me follow up with one quick question, because the light is ready to turn red.

Mr. Moore, I assume you have Chambers of Commerce or something in your area and you talked to your business associates both in your industry and others that may be related to it. Are you finding your concerns about bankruptcy and businesses may be going under because of some results of maybe abuse of the bankruptcy system? I mean, do you find this common among your colleagues in that industry?

Mr. **MOORE.** Yes, sir. As I mentioned earlier——

Mr. **CHABOT.** If you could pull that mike again closer, sir.

Mr. **MOORE.** As I mentioned earlier in my discussion, in talking with other retailers, yes, we are hearing this, of course. As you know, Georgia is one of the higher, as we mentioned, if not, the highest—and there again I am not a professional in this area and I won't try to be, but Georgia has one of the highest percentage of filings in the States. But, yes, this is a continuous chambers meetings, after-hours business meetings, and very reputable and some very old businesses and gentleman that were raised in the business the old way, like myself, just truly do not understand how it works.

Mr. **CHABOT.** Thank you very much.

Page 349 PREV PAGE TOP OF DOC

Mr. **GEKAS.** We thank the gentleman.

We turn to the gentleman from North Carolina, Mr. Watt.

Mr. **WATT.** Thank you, Mr. Chairman.

Let me say first of all, Mr. Tassey and Mr. Moore, I was extremely interested in your testimony from the small town America perspective. And, Mr. Tassey, your comments relating to variable factors resulting in bankruptcy, particularly, led me to this question of when you do, in fact, have variable factors to get you there, whether you can really solve the problem by a one-size-or-two-size-fits-all response to it, which it seems to me that this bill does substantially.

It seems to take a lot of the discretion—more discretion away from judges who might have been able to take into account some of the factors that got people into bankruptcy. I may be misunderstanding that. Maybe Judge Brown can help us evaluate whether this bill reduces judicial discretion or increases judicial discretion. I am going to come back and ask you about that.

But let's get my premise established here first. Maybe I am misstating the issue.

Mr. **BROWN.** Well, it is held out by some proponents, for example, of means testing, but it encourages or increases judicial discretion—I am not certain that is true. I think there still is a lot of judicial discretion under this bill.

Page 350 PREV PAGE TOP OF DOC

I think, for example, if the hope is that we will have uniformity across the United States in bankruptcy practice, that is a misguided hope, because there always are going to be interpretations. As I mentioned in my opening comment, there is already a debate about how do you apply the means test under section 102. So I think there will be judicial discretion.

For example, under the means test, looking at totality of circumstance is already there under 707(b) and could be strengthened and probably should be strengthened to tell judges more specific things to look at. It will still be there, Congressman.

Mr. **WATT.** Are there things either in this bill or in existing law that allow a judge to take into account the means by which a debtor got into debt? Can you take into account the fact that a teaser rate was offered and this person kind of got, you know, roped in to more debt? Is that discretion available now?

Mr. **BROWN.** It is. I mean, for example, there are different levels we are talking about now. For example, under section 707(b) as it exists today, substantial abuse, whether I am going to dismiss a chapter 7 case, I certainly can and should look at a totality of circumstances.

For example, I have dismissed cases—I have seen abusive cases, and I have dismissed cases where debtors bought a brand new car or built a swimming pool just days before filing bankruptcy and said I am not going to pay my debt.

Mr. **WATT.** That is debtor abuse, and I am talking about creditor abuse.

Page 351 PREV PAGE TOP OF DOC

Mr. **BROWN.** Let me shift over to that. If a creditor brings under current law a complaint to deny dischargeability of a debt under section 523(a)(2) dealing with fraud, then I certainly might and would look at all of the circumstances of the debtor's intent to repay that, which might involve whether the debtor understood all the terms of that loan. So, yes, there is discretion there. And some of that can be tightened up, certainly, but there will always be room for some interpretation and discretion.

Mr. **WATT.** Mr. Tassey, I didn't mean—I have kind of gotten off on a side track here. But I wanted you to respond to what seems to me to be an inconsistency that various factors are getting us into the problem, yet we are going to do something that kind of solves a problem that is more complex with one set of factors being able to fit all circumstances.

Mr. **TASSEY.** Sure. Just a quick comment on discretion for a second.

Right now, you might go into Judge Brown's district, and he will interpret substantial abuse in a certain way. You go over to the Eastern District of Tennessee, Judge Price has a decision that says, the ability to pay is not substantial abuse. We lend on a national basis; and, yes, we want as much uniformity, certainty, and predictability in the Code and its application as possible.

In terms of your variability question, as we look at the bankruptcy in two ways, there is a one-size-fits-all in the sense that the people are insolvent, for whatever reason, whether it is a medical event, divorce, whether we fouled up on our underwriting and have extended too much credit, these people can't pay, won't pay. Get them into the system—there has been a failure somewhere. Get them into the bankruptcy system, get the complete liquidation with the relief they need and get them out of the system.

Page 352 PREV PAGE TOP OF DOC

We feel there is a natural rate of bankruptcy. Only about 1 percent of our customers go bankrupt. We don't know which 1 percent that is. About 3 percent have some trouble paying their bills. However, what has disturbed us over the years as the rate of bankruptcy increase has taken off is we feel that there is evidence in that rate of increase are people that have a substantial ability to repay.

And that is when the means test—we want some way to isolate them, to drop out the people that can't pay and to take a second look at these people that seem to have some ability to repay. And they drop out at different levels. There is a lot to that calculation.

Judge Brown referred to some of the discretion like to totality of circumstances or if we happen to bring a motion and it is not justified, we have to pay costs and could be subject to other sanctions, those sorts of things. That is fine. That is all fair, and that kind of discretion is fine.

But we feel that you need to look at this sort of above and below the line. Don't waste time and resources on people that can't pay but take a second look at people that seem to have some prima facie ability to pay and then have a system that drops out in that group some outliers and focus on those that really can repay.

I would just like to comment, Mr. Moore doesn't extend credit through credit cards. Some retailers do.

Mr. **WATT.** Actually, I wanted to ask him a question about that. But I think the chairman is——

Page 353 PREV PAGE TOP OF DOC

Mr. **GEKAS.** I will extend. If you want to have that question answered, I will allow it.

Mr. **TASSEY.** It takes a lot—if he loses the principal and interest on an extension of credit for furniture, it takes a lot of his other customers——

Mr. **WATT.** Let me ask two questions about that. One is, are you making secured or unsecured transactions? I mean, are you taking a security interest in the furnishings that——

Mr. **MOORE.** Unsecured.

Mr. **WATT.** Unsecured. So you give them the furniture. You retain no security interest in it at all. The furniture is gone?

Mr. **MOORE.** Yes.

Mr. **WATT.** And you are unsecured in a bankruptcy situation.

Now, what about credit card debt? This I know you don't—as Mr. Tassey said, you are not extending credit card debt. You are making the evaluation of your customers. But are you seeing a substantial increase among your customers in credit card debt? And to what extent is that a factor in more of your customers ending up in bankruptcy in your assessment?

Page 354 PREV PAGE TOP OF DOC

Mr. **MOORE.** Well, of course, again, I mentioned that I am not an expert, but I do speak as to what I see. And you know, one view, my approvals as being—they are small approvals, all things are still taken into consideration, because our livelihood is based on the performance of these accounts once their put on the books.

We take into consideration the total indebtedness, in other words, the ability of the customer to pay—and I am repeating a lot of what we have already talked about—the ability to pay and, of course, the willingness to pay. That being, with a small business like mine, we have the time, the credit manager to call and check references, we have the opportunity to look at that.

Mr. **WATT.** I heard all of that. I am just wondering how much, if any, increase you are seeing in your experience in credit debt. Is that a major factor in your assessment?

Mr. **MOORE.** As I was saying, in checking these out, of course, the credit card indebtedness is observed. And, yes, it is a varying factor at this time, and we are seeing increases, yes, sir.

Mr. **WATT.** All right.

Mr. **GEKAS.** The time of the gentleman is expired.

We turn to the gentleman from Tennessee, for 5 minutes.

Page 355 PREV PAGE TOP OF DOC

Mr. **BRYANT.** Thank you, Mr. Chairman.

Professor Zywicki, I want to ask you a question that was prompted, I think, by a statistic Mr. Tassey gave us. And I think he has testified in previous hearings about this, regarding an area that is very near and dear to my heart, Shelby

County, Tennessee. That in Shelby County, we, I think, have 32 times more likelihood to file probably chapter 13 or some form of bankruptcy than the Nation. But yet, obviously, we don't get 32 more times the credit. And you had alluded to, in your opening statement, about a myth of credit card being tied to the bankruptcy. Can you put those together?

I have got a couple of other questions I want to ask, so if you could keep your answer relatively short.

Mr. **ZYWICKI.** Sure, I will be brief.

First, the whole concept of credit cards driving this is just not sustainable as an argument. First, for instance, Professor Klee is making a big deal out of bank profits. Bank profits up—until 1992 shared the early entries into the market following deregulation, made a lot of money. MCI made a lot of money right after deregulation of telecommunications, but so what? Since 1992, returns on credit cards have been exactly the same as other sectors of the banking industry. Those high profits have dissipated since 1992.

The idea—the credit card industry is unbelievably competitive right now, 6,000 issuers, millions of consumers, easy switch costs. The idea that somehow this is a noncompetitive market is facially implausible. And the fact that we were getting all of these sort of solicitations is evidence of how competitive it is.

Page 356 PREV PAGE TOP OF DOC

One of the alternatives, telemarketing, door-to-door sales, this is the only way for credit companies to inform customers of the advantage of their cards.

Now, Shelby County or Tennessee, there is an interesting article in *Fortune Magazine*, assuming this is—is this where Memphis is located, in Shelby County?

Fortune Magazine did an interesting article a few years ago crowning Shelby County the bankruptcy capital of America. One of the points they make there is they say, "There is a culture of bankruptcy in Memphis, where it is fairly routine." And the conclusion the *Fortune Magazine* draws is that there has just been a long sort of culture of bankruptcy in that city caused by various different sorts of factors, which is the only sort of thing that can plausibly explain these huge filing differentials between other—between there and elsewhere.

And it is interesting in *Fortune* they say that the implications of this are serious, that the down payment on a used car is the wholesale price of the car. You can't cash a check, according to *Fortune Magazine*.

Mr. **BRYANT.** Let me stop you there. My time is about to run out.

I did want to ask again Judge Brown a question sort of connected to this. But I see where Middle Tennessee, the district there, and I think we have got a couple of folks that will be in the second panel from there, have made a lot of success in the reductions in total number of filings.

Page 357 PREV PAGE TOP OF DOC

But in defense of the Shelby County, the Western District, which also includes other portions other than Shelby County, I think we also set a very good record in terms of many of our filings, larger than national average number of filings are already chapter 13s.

Mr. **BROWN.** They are.

Mr. **BRYANT.** Do you have any explanation as to why we lead the Nation there in that area, as opposed to chapter 7s?

Mr. **BROWN.** You know it is like people always ask me this question, why are there so many 13s in Memphis? And I finally started saying, it is family gatherings. People get together and say, what did you do last year? I filed 13. Well, I guess I better. There is no question but that culture has something to do with it. But it is like every other explanation of bankruptcy. There are a million explanations.

People ask now, what about Tunica, gambling in Tunica? Has that boosted the number of filings? Not really. Sure, it is a factor in a few cases. There are millions of reasons. But it is still largely loss of job, family unit breakup, divorce, things of that nature.

I want to point out, notwithstanding the *Fortune Magazine*, which I don't consider a study—a magazine article can never be a study of anything, but there are 9,600 families now, my trustees tell me, households in Shelby County that are saving their homes in chapter 13 by curing mortgage arrearages, prepetition arrearages.

Page 358 PREV PAGE TOP OF DOC

Chapter 13 trustees paid out over the past year $9 million in priority claims that included child support claims, by the way. They paid out in the Western District of Tennessee over $16 million to purely unsecured creditors who would have received nothing in chapter 7.

You know, I am tempted to suggest what Congress should do is pass a bankruptcy bill that I would call the Memphis bill. If everybody would do it the way we do it in Memphis, it works.

Why do you have so many 13 filings? Because chapter 13 works. If it is done efficiently and properly; and if you have good trustees and if the court is accustomed to do 13s, it works. Is there abuse? Sure. But abuse is a function of people. There will always be abuse as long as there are abusive people, whether they are creditors or debtors.

As I said to people, if you think there is abuse under the current Code, just wait till you see the creative abuse under a new Code. We will never eliminate abuse. We can control it. We can reduce it. I am an advocate of that, but we will not eliminate it.

Mr. **BRYANT.** Thank you.

Mr. **GEKAS.** We thank the gentleman.

We turn to the gentleman from New York, Mr. Weiner, for 5 minutes.

Mr. **WEINER.** Thank you, Mr. Chairman.

Page 359 PREV PAGE TOP OF DOC

Mr. Tassey, and then I guess, Professor Klee, I would like you to respond to this as well. Can you make the justification or make the argument for credit card debts and cash advances having a presumption of nondischargeability or nondischargeability under this, as opposed to, I guess, the present laws that if there is bad faith on the part of the borrower it is that that presumption exists? I mean, are you familiar with what I am referring to?

Mr. **TASSEY.** I think current law is there is a presumption of nondischargeability within 60 days, am I not correct, and it is $1,000. You get a free shot of up to $1,000. The bill, as I understand it, it is now—it extends that period for 30 days, and you get $250 in luxury goods per creditor, and then you get unlimited necessities. So I think we do see a lot of bankruptcy planning, and that is when credit card use comes into play in bankruptcy, it tends to occur, people have a couple of credit cards lying around in the drawer, they will use them prior to filing bankruptcy. And this is a presumption.

Mr. **WEINER.** They used them prior to filing bankruptcy as a planning method or because that is the last credit that they kind of—they can spend?

Mr. **TASSEY.** It depends on the situation. For the one category of person I am talking about, we said we look at bankruptcy above and below the line. There are a lot of people who lose their job, they may have a medical situation or what have you. They have a couple of credit cards lying around in the drawer. They say, I will float myself on these credit cards till I find a job. You know, it is no problem with the intent there, that sort of thing. That is one scenario.

Page 360 PREV PAGE TOP OF DOC

The other scenario is in the section of bankruptcies that we are talking about, the bankruptcies of convenience or planning bankruptcies, where they consciously use that as a pre-bankruptcy-planning tool. They may try and pay debts that are otherwise nondischargeable like State taxes, things like that, with the dischargeable debt. They may make material acquisitions. And, under the bill, they still have a substantial leeway to do so.

Mr. **WEINER.** Professor Klee, you take exception to that provision of H.R. 833?

Mr. **KLEE.** We take exception to it, Congressman, but current law is not crystal clear on what happens. The law should be and ought to be clear that if the debtor does not intend to repay the debt, then it is incurred by fraud and it is then nondischargeable; and current law would cover that. Where the cases are in disarray is whether the use of an ATM card prior to bankruptcy can support the automatic presumption that the debtor doesn't intend to repay. And some courts say yes and some courts say no, and that is disarray.

This bill would make the use of the cash card, I think within 90 days of bankruptcy, automatically nondischargeable, whether it was used to buy groceries or to pay a medical bill or an emergency room bill or whether it was used to go gambling or take a vacation.

Mr. **WEINER.** I understand.

Let me get to one more question before—I understand you have more to say, Mr. Tassey, maybe on the second round if there is one.

Page 361 PREV PAGE TOP OF DOC

Perhaps you could shed light on one question that has nothing to do with expertise on the bill, but it is the great mystery of how much those of us who don't file for bankruptcy will benefit or not benefit from the passage of this law. If we pass this law tomorrow, what you have come to understand about it and the number of—and because we are difficult people to file for bankruptcy, will you be passing along savings to your customers in any form?

Mr. **MOORE.** At any time that we can operate with—and there, again, I am not a professional. I am not going to get in too deeply. I will answer that simply, yes, sir.

Mr. **WEINER.** And how will that yield—say I have got less or fewer people defaulting on loans is your theory, fewer people defaulting on credit and paying you more fully? Where are your savings going to come from so I understand how your customers are going to save?

Mr. **MOORE.** Well, basically, as I mentioned earlier, we are looking at $30,000 a year in a small business environment at this time. As far as the local situation in the savings extended, of course, due on a dealership, which—the price is regulated by a larger corporation, and that would be a question, you know, that would need to be extended to that level.

Mr. **WEINER.** I would ask, Mr. Tassey, to respond to that last question as well. Your member institutions will be passing along savings to consumers, I mean, so we will see in theory lower interest rates, because they will be——

Page 362 PREV PAGE TOP OF DOC

Mr. **TASSEY.** It depends on how the product is priced. The lower interest rate is one possibility. If you compete solely on the basis of interest rate, Wachovia has the lowest rate of 8.8 percent, yes, they will probably pass that on.

You may compete through airline miles. There may be a lot of different things. You may offer more airline miles. You may extend more credit. You may take that savings and say, I can use that as principal for another loan.

The other ways that recovering this money will help is that the first stop, of course, is the Federal Government. We deduct these things as bad debts.

So there is a lot of flow-through. The interest rate is just one of many ways that these costs get passed through. It could be increased dividends to shareholders, which include pension funds. It could be increased payments in affinity fees to organizations, like the AFL–CIO has got an affinity arrangement with Household, those types of things.

All of those things are part of how credit cards are priced and how these savings are passed on. They just focus on the interest rate frequently. That is the least of it, to be honest with you.

Mr. **WEINER.** Thank you, Mr. Chairman.

Mr. **GEKAS.** Does the gentleman from Massachusetts seek time? That is a silly question. The gentleman from Massachusetts is recognized for 5 minutes.

Page 363 PREV PAGE TOP OF DOC

Mr. **DELAHUNT.** I probably won't use my 5 minutes, Mr. Chairman.

I have got to ask, Judge Brown, in terms of the administration of 8—I think it is H.R. 833, will there be additional costs? My memory is from the testimony, however long ago it was, last year, the year before, it was prior to impeachment, that is what I remember, there was considerable testimony that the bankruptcy court and the system itself would need significantly more resources. Is that a fair statement?

Mr. **BROWN.** I think it is true that there will be higher administrative costs. Maybe that is unavoidable, to some extent. But, for example—just to use an example that was mentioned by one of the witnesses, the filing of tax returns. Now, there is a beneficial effect, to have tax returns available to trustees, but why file the returns? As I understand it, an alternative may be they might be available electronically to the trustee from the IRS, and if the trustee then wanted the paper, then that trustee could obtain it.

But if you burden the clerk's office, for example, of every court in the country, bankruptcy court, with that much paper, that is a lot to deal with, it will require more personnel. It is more administration. Certainly, the means test has some more administration. But, in all honesty, a lot of these things would begin to fall out and fall into place after a pattern of administration was established.

So I don't want to exaggerate the administration. But there will be some increased costs of administration. It is more probably on the trustee side than anything, the panel trustees having to look more closely at some things and spend more time and more money doing that. And there needs to be some attention given to how do we incentivize the trustees to do that? How do we make sure they get paid for that?

Page 364 PREV PAGE TOP OF DOC

Mr. **DELAHUNT.** So presuming that H.R. 833 passes pretty much as it is presently crafted, at least for the first year or two, we should be realistic in providing additional resources during transition phase, if you will?

Mr. **BROWN.** I think so.

And another area that hasn't been touched on, just the cost of—the United States trustee program doing debtor education or endorsing or approving credit counseling agencies. That is obviously going to be an expense to the entire system that must be borne.

Mr. **DELAHUNT.** Does anyone else have any comment? I saw somebody. Professor Klee.

Mr. **KLEE.** Congressman Delahunt, I think the transaction costs of this bill have been overlooked. And that is one of the reasons that I opted for a——

Mr. **DELAHUNT.** That is why I asked the question.

Mr. **KLEE** [continuing]. A straight income test in my article. Sure, you would like to determine ability to pay, but if the cost of determining ability to pay exceeds the benefit of making the determination, you have to settle for a more efficient and expeditious bright-line test. We have 1.4 million cases that are being filed, and to have the trustees scrutinize this information and have the judges conduct these abuses hearings costs the taxpayers money. So if there is going to be an effort to ferret out abuse, it should be one where the benefit to the system outweighs the cost.

Page 365 PREV PAGE TOP OF DOC

Mr. **DELAHUNT.** I would like to direct the question to Mr. Wallace. It is good to see you again here, Mr. Wallace.

Mr. **WALLACE.** Always a pleasure, sir. It is going to be the same question you asked me last year.

Mr. **DELAHUNT.** Probably. Do you remember the question? Why don't you just give the answer now?

My memory is that last year, the question I asked was, what do you anticipate to be the reduction in the number of filings?

Mr. **WALLACE.** Actually, you didn't ask me that question.

Mr. **DELAHUNT.** Let us try that.

Mr. **WALLACE.** Of course, it is difficult to predict how—the exact effect and detail, and I am unable to do that. I think I responded last year that I don't usually predict the future and——

Mr. **DELAHUNT.** That was your response last year. I thought maybe——

Mr. **WALLACE.** We are both remembering what it was. That is very helpful. I am not sure I want to change that answer. I think it is probably pretty accurate.

Page 366 PREV PAGE TOP OF DOC

Nonetheless, with additional study, it does seem as though there is going to be some slight increase in what I would call improper bankruptcies, improper use of the bankruptcy process, and I think that is beneficial.

Mr. **DELAHUNT.** Can you quantify it at all?

Mr. **WALLACE.** No I cannot.

Mr. **DELAHUNT.** You cannot quantify it. I mean, as you know, I think that is a concern that many of us have, namely, that the data itself just leaves us with unease in terms of prediction. I mean, I polled the panel yesterday regarding a very simple question—and I think, Mr. Tassey, you responded well to it—whether we can expect a reduction in interest rates if the bill becomes law. And the panel yesterday was unanimous in the fact that they didn't really think that interest rates would come down.

Mr. **TASSEY.** Do you want me to respond to that?

Mr. **DELAHUNT.** Sure.

Mr. **TASSEY.** Well, again, Congressman, you know, I can't say that with the reduction in bankruptcy that is the result. My point is that the interest rate is frequently the—it is just one factor in the credit card pricing and one factor in the business of extending credit. There is a lot of different ways those savings will be passed on.

Page 367 PREV PAGE TOP OF DOC

The first does go to the taxpayer, though, because we are no longer writing off those bad debts.

Mr. **DELAHUNT.** We are offsetting that in terms of additional transaction costs, Professor Klee said that.

Mr. **TASSEY.** It is not clear.

Mr. **DELAHUNT.** The problem is, it isn't clear. That is my point.

Mr. **TASSEY.** I think it is not clear in a different direction.

Mr. **DELAHUNT.** Can I have an additional 2 minutes, Mr. Chairman, in lieu of a second round for me?

Mr. **GEKAS.** When you said that you were not going to use 5 minutes, you meant that you were going to use 7.

Mr. **DELAHUNT.** I was just kidding you. The 2 minutes is an——

Mr. **GEKAS.** Without objection, 2 more minutes.

Mr. **TASSEY.** Sure. I think what is going to happen, first of all, the additional work in the means test is not that complex. The debtor also files a schedule I and J. There are some additional calculations that lend themselves well to a PC format. Any preparer, bankruptcy petition preparer, should be able to perform this calculation. And they are going to tell the debtor, look, if you file, you are most likely to go into 13. It is not going to get to the point where, hopefully, Judge Brown is going to have to have a hearing.

Page 368 PREV PAGE TOP OF DOC

And maybe they will take a different tack. Maybe they will go to—maybe because of the Consumer Credit Counseling provisions in the bill or maybe they will just decide bankruptcy is not such a great deal after all, those kinds of things, maybe they will do something else.

In terms of your question as to how much are we going to reduce the overall bankruptcies, I think you are looking at reducing the rate of increase—we feel there is 10 percent, roughly, of overall filings that are of concern. Somewhere in there you are going to get a reduction. I can't give you a percentage. You will get a reduction. And I think you will improve recoveries, and you will see a different kind of chapter 13.

Mr. **DELAHUNT.** Let me just close with one last question, and let anyone who is able to respond to it.

You know, in terms of public confidence in the system, and I think the proponents of the bill have argued, and I think fairly, that there is abuse in the system and that many in the public sense that the integrity of the system is suspect. And yet last year I had—in the course of the markup—an amendment which would have capped the real estate exemption at $125,000. It passed unanimously in subcommittee, it passed in the Full Committee, and yet when we got to the floor of the House, it lost.

You know, when people get their information today, they receive it in a variety of ways. Now we are hearing about Burt Reynolds, who is a famous actor. And he owns a home called "Valhalla," and he has got $2 million plus equity in that home. And here we are talking about the integrity of the system. He is allowed to keep $2 million worth of his equity, and yet we have others who are barely scraping by.

Page 369 PREV PAGE TOP OF DOC

Does anyone on this panel see any reason not to cap the exemption on personal residences?

Mr. **ZYWICKI.** There is a study by Michelle White, who is an economist at Michigan, the McCoy Journal of Economics from a few years back. What she finds is that, especially in Texas, that it is a policy decision that the State legislature of Texas has made. The evidence indicates that there is—the people in Texas, because of their homestead exemption, get somewhat less access to credit, approximately $15,000 on average is what she estimates, and you are more likely to be turned down for a loan in Texas if you—because of the homestead exemption.

Whether or not that is a sensible trade-off for the Texas legislature to make, to allow some people to maintain assets while other people have less access to credit could be debated, but I think that is essentially the argument, and that is what the evidence shows.

Mr. **GEKAS.** The time of the gentleman has expired.

The gentleman from New York has requested an extra question.

Mr. **NADLER.** Thank you. I have a question for Professor Zywicki, in light of what the professor said a little while ago about it being clear that increase in consumer lending of credit card debt is not the prime cause of the increase in bankruptcies.

I want to read something from the prepared statement which wasn't testified to but submitted by one of the witnesses yesterday, and then ask you to comment on it.

Page 370 PREV PAGE TOP OF DOC

Should there be doubting Thomases about the growth of consumer credit being virtually the only real cause for the increase in personal bankruptcies? We need only look at the Canadian experience. Interest rates in Canada have been deregulated at least since 1886, but personal bankruptcies there were not a noticeable problem prior to 1968. In 1968, 2 years after the development of the Visa and Mastercard associations in the United States, Visa entered Canada, resulting in dramatic growth in credit card loans. As a result, personal bankruptcies started rising sooner in Canada than in the United States.

This cannot be blamed on changes in Canada's bankruptcy laws, because Canadian bankruptcy laws have not been changed. Personal bankruptcies grew sharply and immediately after Visa entered Canada. From 1966 to 1976, the personal bankruptcy rate in Canada grew 340 percent. Over the same period, the rate in the United States grew 8 percent.

One explanation for this difference in rates may be that the State usury laws were eliminating the availability of credit in the United States during that period prior to the *Marquette* decision, while the absence of usury sales in Canada was permitting the expansion of credit card debt to more high-risk borrowers. After interest rate deregulation in the United States resulting from the *Marquette* decision over the next decade, the personal bankruptcy rate in the United States and Canada followed a remarkably similar pattern. Between 1976 and 1986, the Canadian bankruptcy rate grew by approximately 93 percent and the U.S. bankruptcy rate by 72 percent.

In 1986 to 1996, as the credit card industry underwent rapid innovation and expansion, personal bankruptcy rates in both countries grew dramatically. In Canada, the personal bankruptcy rate grew 225 percent; in the U.S., 123 percent.

Page 371 PREV PAGE TOP OF DOC

The Canada experience indicates that changes in our Federal bankruptcy laws have not been a significant factor in the rise of personal bankruptcies in the United States. During all of this period the unchanged Canadian bankruptcy laws have been far more restrictive than the U.S. bankruptcy laws, but those laws were not effective against the onslaught of unsecured credit foisted on debtors by credit card issuers.

And I point out two other things and then ask for your comment.

One, as you can see from this chart, the consumer bankruptcy cases rise parallel exactly or almost exactly to the rise in consumer debt on an annual basis from 1978 to 1998.

And one other fact you mentioned before, that you were asked a similar question, for some reason you started talking about competitiveness among credit card industries, which I didn't—among credit card companies, which I didn't think had anything to do with the subject.

But, in any case, five banks offer 43 percent of the credit cards in the United States, and 80 percent is issued by 50 banks. Now, I don't know what this has to do with anything. Why we can't have many people who are issuing the credit cards? But it is very few considerably.

So in view of the Canadian experience and in view of the fact that debt—that bankruptcy cases are very neatly tracking the increase in consumer credit card debt, would you comment on why you disagree with the conclusion that increased credit card debt availability is basically the only cause and not the changes in the bankruptcy laws, which haven't changed in Canada?

Page 372 PREV PAGE TOP OF DOC

Mr. **ZYWICKI.** I am obviously not an expert on what is going on in Canada. And you refer to Diane Ellis' article. The whole issue of deregulation and sort of pinning it to the *Marquette* decision is much more complicated than Ms. Ellis portrays in that article.

For instance, the onset of deregulation in the United States, sort of echoing what Mr. Tassey said earlier, the first thing that happened—or, more precisely, under—when there were usury ceilings, basically what banks did to evade the usury ceilings was charge annual fees. As real interest rates went up, they raised annual fees, which was essentially implicit, sort of an interest rate, as they got rid of——

Mr. **NADLER.** Do they still charge annual fees?

Mr. **ZYWICKI.** I don't have an annual fee on any of mine.

Mr. **NADLER.** All of mine do.

Mr. **ZYWICKI.** You should read some more of those fliers that come in. No, the annual fees have disappeared. Increases in benefits such as frequent flier miles, all of these other sorts of things have arisen.

So to sort of just look at interest rates is like saying the car companies should always just cut the price rather than raising their quality or something like that.

Page 373 PREV PAGE TOP OF DOC

Secondly, the argument that things are correlated is just not an argument regarding causation. As I mentioned earlier, the fall in interest rates in recent years has reduced current debt levels and current debt burden substantially. And so that—and current debt levels would seem to me how much you have to pay each month.

Mr. **NADLER.** The fall in interest rates, are you saying that consumers are paying much lower interest rates on credit card debt these days? I hadn't noticed that either.

Mr. **ZYWICKI.** Number one, interest rates have gone down.

Mr. **NADLER.** But not on credit cards very much. They have gone down on everything else.

Mr. **ZYWICKI.** They have gone down on credit cards. There is a noticeable drop in——

Mr. **NADLER.** The average credit card rate in the United States today—I think I read the other day is 15.7 percent, down from 17.2 a few years ago. That is not much of a drop.

Mr. **ZYWICKI.** It is a drop.

Mr. **NADLER.** Not much.

Page 374 PREV PAGE TOP OF DOC

Mr. **GEKAS.** It is a drop.

Mr. **ZYWICKI.** Secondly, and also there has been this basically implicit loss of interest rate theory, getting rid of annual rates, et cetera. The key point that I think needs to be recognized is that home mortgage debt swamps credit card debt in the system, and home mortgage debt has been rising far faster than credit card debt has in recent years. If there is anything—that the estimates are something—what—4 or 5 trillion in home mortgage debt, as opposed to 500 billion or something in credit card debt. Home mortgage debt is rising faster.

If you even look at Mrs. Ellis' study, you will see what you mentioned about high-income versus low-income. She just misreads one of her own charts in there. From 1992 to 1995, the greatest growth in credit card borrowing has been among high-income debtors, not among low-income debtors.

Basically, there is a big break in 1992, where bank profits stabilized, where interest rates started falling. And basically what is that attributable to, consumers have become more knowledgeable about how to use their credit cards. They have learned how to surf among credit cards, if they need to in order to get the lowest rates. And, as a result, you see a dissipation of bank profits. You have seen a fall in interest rates. You have seen an increase in benefits associated with credit cards.

Mr. **NADLER.** First of all, let me just note that I wasn't aware that suddenly in 1992 everybody got educated, but maybe.

Page 375 PREV PAGE TOP OF DOC

Let me ask Professor Klee if he would briefly comment on this dialogue.

Mr. **KLEE.** I think it is fair to say that credit cards today are more competitive than they were. For years, as a well-qualified, high-income borrower, I had to pay the same 17 or 18 or 20 percent interest rate as everybody else. Now there is competition for that, and they are reducing the rates down to 10, 12, or 7 percent for qualified high-income borrowers.

So the average blended rate for rich people has come down. But for poor people, I don't think it has come down at all. I do want to say that I agree that mortgage lending is going way up. And for people who aren't renting, mortgage debt is a significant factor. For the renters, it is a nonfactor. But for the people who do own homes, subprime lending is probably the biggest threat to the bankruptcy system and to the credit card industry that we face today.

Subprime lending, where 125 percent of value is being loaned against houses on home equity loans, is not only pricing credit companies out of a lot of their loans, but it is putting debtors in a position that, when they get overencumbered with debt and they fail to pay, they are going to lose their houses.

And this subcommittee could be confronted with the type of 1930's moratorium legislation crisis 4 or 5 years from now if something isn't done to control what is going on with home equity loans, which are being influenced in part by the Tax Code.

Mr. **GEKAS.** The time of the gentleman has expired.

Page 376 PREV PAGE TOP OF DOC

Mr. **NADLER.** Thank you.

Mr. **GEKAS.** And expired and expired.

The chair yields itself 5 minutes for its first chance at asking some questions.

Professor Klee, one of the criticisms of the bill that we have advanced here is—it sounded like a criticism—that the only result would be a—or one of the only results would be that the credit lenders would be making more profit. That implies, to me, that there is an acknowledgment that, if our bill worked, more people in 13 who were under our test pattern would be able to repay some of their debt, would be actually repaying it. Why is that a bad thing to, first of all, to make a profit?

I like the idea of the credit lenders making profit. I always did, or anybody who invests or anybody who does business or anybody who employs the marketplace or anybody who gives services and goods. I want them to make a profit. So I don't consider that a devastating effect of our bill, that, my gosh, credit lenders might be making a profit as a result of some of these things.

Now, here is the specific question. When you say that profit would be increased, are you saying in a hypothetical that, with a thousand loans made by a credit company, that under our bill that their write-off would be less or that they would make more than if the thousand were actually paid back? What did you mean by the bad effect of our bill that had a profit increase?

Page 377 PREV PAGE TOP OF DOC

Mr. **KLEE.** Let me answer both questions.

First, Mr. Chairman, I am not opposed to credit card companies making profits. I own stock in several credit card companies and have profited handsomely and hope to continue to do so. Bankruptcy, however, is a zero sum game. And to the extent some people are making profits, other people aren't getting the money. And that is why the child care priorities and things were such a political fallout from the bill.

I think what will happen if this bill becomes law is that, of the losses that you have in bankruptcy today, $550 billion or whatever the credit industry is currently quoting, only a small fraction of that will be repaid. Because some people just don't have anything to repay. Whether there is no bankruptcy at all, the defaults will still be there.

For some percentage. Though, there will be increased repayments in chapter 13, so the write-offs will be lower for those lenders. Now——

Mr. **GEKAS.** Exactly what we intend.

Mr. **KLEE.** It might not be the credit companies, though, because the way you put the anti-lien stripping provisions in chapter 13, it is probably going to be the auto financiers who wind up getting paid more money on the car loans than the credit companies who get——

Mr. **GEKAS.** But if it is all based, Professor Klee, on a sensible, reasonable repayment of debt that is based on an ability to repay, what difference does it make? And that is just a rhetorical question as to who makes progress, because I want to ask Judge Brown a question.

Page 378 PREV PAGE TOP OF DOC

Mr. **KLEE.** Because the difference is, Congressman, I and the other American taxpayers are financing a collection system so the credit companies and the car loan lenders can make the profits. You see, what is going to happen is——

Mr. **GEKAS.** Isn't that the case now under the current system?

Mr. **KLEE.** No.

Mr. **GEKAS.** You mean the bankruptcy court system does not succeed in collecting monies for anybody?

Mr. **KLEE.** No, I mean the incremental costs to the bankruptcy system will be increased by this bill with an incremental cost borne by the taxpayers, because there will have to be more inquiry by the trustees, more education and administration by the U.S. trustee, and more judges to hold "abuse" hearings.

I agree there should be reform, and there should be bright-line abuse standards, and people should be forced to repay if they can repay at high-income levels. It is the transaction costs that might be more than the benefits.

Mr. **GEKAS.** Seizing back my time.

Judge Brown, you seem to have stated that at some point—I took some of your testimony to imply at least that uniformity or reduction of disparity may not be a good thing.

Page 379 PREV PAGE TOP OF DOC

Mr. **BROWN.** No.

Mr. **GEKAS.** Let me just say, because I believe that when I first became involved in this and started to craft last term's effort that we did so partially, just like in the criminal law we did on sentencing guidelines, to reduce disparity of outcome, that we wanted to have this means test objective set of standards. Why? So that a bankruptcy in Oregon on all fours matching a bankruptcy in Maryland would be likely to have the same outcome, rather than one escape completely and the other have to go to 13, that type of situation. Isn't that a good intent on our part?

Mr. **BROWN.** I agree, Congressman. That is a very good intent.

I mean, I did not mean to say disparity is a good thing or we should discourage uniformity. I simply was pointing out that I am not convinced that under this bill or perhaps under any bill that we will have an absolute uniformity.

Certainly, a bright-line test, a means test of some type would encourage uniformity. That is good. That is a good result. However, there still would be disagreements about how any test is applied. And one of the omissions from this bill, of course, is anything that addresses appeals. I think that the way to get uniformity is to have a quicker appellate process and more certain uniformity of law, case law, that says, for example, this is what abuse is under case law.

Mr. **GEKAS.** But you have to acknowledge, it seems to me, Judge, that any reasonable application of standards, objective standards, could lead more efficiently to a uniform system than one that allows the current system, allows the discretion of each judge to do whatever it wants to under the factual circumstances of that case. And that is—we believe we are addressing a major, major flaw in the current bankruptcy system. I want you to know that.

Page 380 PREV PAGE TOP OF DOC

Mr. **BROWN.** I agree that is a good thing. I just personally think, for example, there—I may not agree with Professor Klee exactly on how to get there. I think there is a simpler bright-line test that can be agreed upon.

Mr. **GEKAS.** You may feel free to write a white paper on us and let us examine it.

Mr. **BROWN.** We will have one.

Mr. **GEKAS.** The time of the chair has expired.

We now discharge this panel with the thanks of the committee. And I want to reemphasize something that I try to do each time we have had a hearing. Last term, when we offered the-then vehicle for bankruptcy reform, we changed it mightily almost every time that a panel appeared and had suggestions or criticisms, and thus we were able to use the testimony of the witnesses very efficiently in changing the thrust of the bill and the final outcome, which garnered over 300 votes in the House and a majority in the Senate in the first version, et cetera, and even in the conference report.

So you should feel confident that what you have rendered here in testimony today is not just a part of the record, it is a part of our psyche and a part of our ongoing effort to bring about meaningful bankruptcy reform. We thank you very much.

We now invite to the witness table the distinguished Governor of Delaware, Tom Carper. As he approaches the witness table, we want to note that this individual, who has just been reelected to his second term as Governor of Delaware, had previously served in Delaware as State Treasurer for five or six terms, I believe. How many? Six years was it?

Page 381 PREV PAGE TOP OF DOC

Governor **CARPER.** Six years, yes, sir.

Mr. **GEKAS.** And then served in the Congress of the United States. His combined service as Governor and State Treasurer, we understand, sets a record for public officials in Delaware as having been elected statewide more than any other individual in Delaware history.

He comes to us today to testify on behalf of the Governors' Association of the United States, where he is chairing the entire conference; and we welcome his testimony.

And for those who are in the audience, you should know that the gentleman from New York and I have agreed that this will be the final witness for the morning session, after which we will adjourn for an hour before resuming. So you may make your interim plans pursuant to that plan.

But for the time being, we welcome the testimony of Governor Carper.

STATEMENT OF THOMAS R. CARPER, GOVERNOR OF THE STATE OF DELAWARE, ON BEHALF OF THE NATIONAL GOVERNORS' ASSOCIATION

Mr. **CARPER.** Mr. Chairman, thank you very much. And to you and to each of the members of the committee that are here today, thank you for giving me a chance to appear here on behalf of the Nation's governors. I come here really wearing three hats: One of those is chairman of the National Governors' Association, second is as Governor of Delaware, and the third is really as sort of a citizen's hat. And I will talk a little bit about that later.

Page 382 PREV PAGE TOP OF DOC

As I got off the helicopter and worked my way over here and through the building, I noticed a lot of people wearing green as they are wearing back in Delaware today as we are celebrating St. Patrick's Day. One of my friends likes to say, when you talk about green, green is the color of money; and in some respects what we are talking about is money. One of my favorite things is, in the end, it all comes down to money.

But I think what you are doing here today deals with more than just dollars and cents, more than just money, but what you are trying to deal with here is matters of fairness and equity and justice to debtors and to creditors and to us as taxpayers.

I told Jonathan Jones, my director in my Washington office, as we were coming over, I said, ironically, 34 years ago this week I was here in this building, and I was an 18-year-old midshipman in Naval ROTC, midshipman from Ohio State. It was spring break, and the kids who had money went to Florida or some place like that, warm. I didn't have money. I ended up with some of my fellow midshipmen going down to the Marine base just a little south of here to see how they were training Marine officers.

I didn't want to be one. I wanted to take a little time. It was a little warmer than Columbus, Ohio, at Ohio State at that time. We ended up having the afternoon off, and I took a train up here to Washington. I got off down at the train station, and my colleagues decided they would go to Georgetown to see if they could get into trouble. I decided to take a walk up here to Capitol Hill to see what was going on.

And as it turned out, not a whole lot was going. The House and the Senate were in session. I worked my way over to this new building, and I asked one of the security guards if anything was going on. I explained where I was from and what I was doing. He said he thought there was a hearing going on in the Judiciary Committee that day, and he pointed me down in this direction. And, indeed, there was.

Page 383 PREV PAGE TOP OF DOC

There was a hearing going on chaired by, as I recall, Emanual Celler, who was then the chairman of the Judiciary Committee. And the hearing that they were holding that day was on the Voting Rights Act of 1965.

The legislation that you are considering does pertain to rights, and it pertains to our rights as individuals to credit in this country. It pertains to the right to protection from creditors, from those of us who find ourselves in some difficult financial circumstances.

You are considering the rights that the children have to make sure that they are looked after through child support payments and that former spouses receive the alimony payments that they are due. And you are talking about the rights that we as debtors, people who borrow money, have to understand clearly what the financial consequences are of us taking on debt, in some cases of not paying that debt and maybe just making minimal payments on the debts that we owe.

The rights that we enjoy as Americans bring with them certain responsibilities. Our right to vote brings with us the right to make informed decisions as to how we cast our vote. Our right to consume alcohol brings with it the right to consume that alcohol responsibly and to not undertake activities that would endanger ourselves or others.

Our right to firearms, similar kinds of responsibilities. Our right to freedom of speech brings with it the right not to defame others. And our right to drive a car brings with it the right responsibility to drive responsibly.

Page 384 PREV PAGE TOP OF DOC

Creditors have the right to lend money. And creditors come, as you know, in all different kinds of shapes and sizes; and they have a right to lend us money. They also have an obligation to make sure that we understand what we are up against if we borrow money from them and if we don't pay that money in a timely way.

And, again, those of us who have a right to borrow have some responsibilities as well to make sure that we are not taking on more than we have the ability to repay.

I come from a State where we have a lot of banks. I know others of you do as well. Some of our banks issue credit cards. Some of your banks issue credit cards as well. I don't believe that all lenders, creditors lend responsibly and make prudent decisions as to who to issue credit. I know that not all borrowers or not all debtors are meeting their responsibilities either and you know that as well.

My parents grew up in the Depression. My guess is that parents of some others in this room grew up in the Depression as well. They taught my sister and me some basic things. They taught us to be tolerant of other people, they taught us to be charitable to other people that were less fortunate than others, and they taught us to be compassionate and helpful to people who needed our compassion and our help. And they also taught that we have a responsibility to look out for ourselves and to make our own way and to be self-sufficient.

You have heard testimony galore last year and this year about the kinds of increases we have seen in personal bankruptcy. I know that some of those 1.4 million people who declared bankruptcy, I guess a year or so ago, a lot of them needed that protection that is afforded them by the law. I know a lot of children today need better protection to make sure that they are getting the money that they need for food and clothing and to meet their bare necessities.

Page 385 PREV PAGE TOP OF DOC

I know there are a lot of former spouses today who need protection from revision of the current law so their needs can be better met. I know there are a lot of retirees who are drawing down IRAs and other tax-approved credit plans who need protection that this legislation and other legislation would provide for them.

I also know and, you know, too, a number of the people, 1.4 million people, that file for personal bankruptcy over the last year or so, a number of those people do have the ability to repay. And the tough decision for you and for your colleagues over in the Senate is to figure out where do we draw the line and how do we determine whether folks do have that ability to repay and how do we make sure that they meet their obligations.

You might wonder, why do governors have an interest in this? And I will just mention briefly. When people declare personal bankruptcy and don't meet their obligations, whether it is a creditor or whether it is a vendor, those of us in our own families end up helping to make up the difference, and it falls on us, I am told, as much as $500 per family per year.

When people don't meet their personal obligations to their creditors, in many cases they don't meet their obligations to the Federal Government for tax obligations. And, as it turns out, neither do they meet their obligations to State governments or to local governments. So I am here today to remind you of that and to really make four points, and then I will wrap it up.

Number one, I would just encourage it, when you figure out what you want to do and work out your compromise with the Senate, to put in place legislation that will, as best you can, prevent people from using chapter 7 who really ought not to be using it; to give a judge or whoever is presiding over those deliberations some flexibility so that whatever formula you come up with they have some discretion in cases where there is extraordinary cases.

Page 386 PREV PAGE TOP OF DOC

Second, I would encourage, and I think when I look at your bill and the bill that I understand has just been introduced over in the Senate by Senators Grassley and Torricelli that you put a high priority on family and kids and, particularly, former spouses who are counting on folks who might be using bankruptcy to escape those responsibilities, give those a high priority. And I think you have given them the highest priority, and I encourage you to keep that priority there.

The third point I would make is that currently, under law, the Federal Government has claims under bankruptcy for some of the assets that might be used or at least an obligation to repay the Federal Government. The State governments don't. And we don't have the kind of notification under current law that the State and local government would like to have and need to have.

The legislation that you have introduced provides for raising the priority of State claims and local government claims. It doesn't put it us on par with the Federal Government. We would ask you to look at that as you go through the processing. Our hope would be whatever priority is assigned to the Federal Government, you would assign a similar priority to the State. We appreciate very much the notification elements that are in your bill to notify State governments.

The last thing I would say, there is a provision, as I understand it, in your legislation that would preserve the right of States to establish our own exemptions under State bankruptcy laws, and we are appreciative of that and hope that something along those lines will be included in the final bill.

Page 387 PREV PAGE TOP OF DOC

Just the last comment. I would say I was disappointed last year, and I know a number of you, you worked real hard to try to come up with the compromise, the right compromise on this point, and there aren't too many Solomons that served with me when I was in the House, and what we are looking for is some Solomon-like judgment. I don't underestimate the difficulty of what you are trying to do.

Just as I was disappointed last year when you came up a little empty in the ability to come up with a compromise that could be sent to the President, I am very much encouraged by the bipartisan spirit that seems to be gathering around legislation in the House and in the Senate.

I know that the bill that you are holding your hearing on, H.R. 833, I realize that is not going to be the bill that is enacted any more than the Grassley/Torricelli bill as it has been introduced will be enacted. The important thing to do is put it out there, to ask people from all perspectives to come and take a shot at them and see what you like and what you don't like.

It is above my pay grade now to figure where the appropriate middle ground lies, but it is right about your pay grades. And I am very much encouraged and hopeful when we finish up and you finish up your work and get all of these hearings behind us we will come up with legislation that gets us closer to where we ought to be as a Nation.

And I thank you for a chance to come by.

Page 388 PREV PAGE TOP OF DOC

Mr. **GEKAS.** We thank the Governor very much.

[The prepared statement of Governor Carper follows:]

PREPARED STATEMENT OF THOMAS R. CARPER, GOVERNOR OF THE STATE OF DELAWARE, ON BEHALF OF THE NATIONAL GOVERNORS' ASSOCIATION

Mr. Chairman, thank you for inviting me to testify today on behalf of the National Governors' Association. I am currently the chairman of the National Governors' Association and the governor of Delaware. I know that you have already heard about the pressing need for bankruptcy reform from several witnesses during these hearings and many more during your deliberations on this issue last year, and I appreciate the opportunity to share the governors' perspective on this important issue.

The reason that you may have heard about the need for bankruptcy reform from so many different groups on so many different occasions is the sheer magnitude and the unique nature of this problem. The nation's economy has been incredibly vibrant during the past several years, enjoying one of the longest peace time expansions in the history of our country. But despite the economic health of our country, personal bankruptcy filings have exploded during that same time period. Almost 1.4 million personal bankruptcy petitions were filed last year, representing one out of every sixty-eight American households. This represents an increase of 95 percent since the beginning of this decade, when personal bankruptcy filings totaled slightly more than 700,000.

Our economy has been setting the right kind of records in the 1990s in terms of real economic growth, low inflation, declining welfare rolls, and falling unemployment rates. However, during the same period, however, personal bankruptcy filings have repeatedly set the wrong kind of records, reaching new highs during each of the last three years. Our economy is enjoying overall health despite the disturbing rise in the number of bankruptcy filings and the costly burden they impose on the country, states, and hard-working American families. More than $40 billion in total debt is discharged yearly in bankruptcy proceedings, costing each U.S. household roughly $500. We need to fix the deficiencies in the existing bankruptcy system, or the high cost that bankruptcies exact may eventually play a contributing role in slowing our overall economic growth.

Page 389 PREV PAGE TOP OF DOC

At our recently concluded winter meeting, the National Governors' Association approved a policy to address these deficiencies. The nation's governors recognize the need to revise federal bankruptcy laws to curb the rapid increase in the number of filings and to stem abuses of the bankruptcy system. Specifically,

We support efforts to prevent the use of Chapter 7 filings by individuals with the ability to pay part or all of their debts.

We also strongly encourage you to ensure that any bankruptcy reform legislation provides the highest possible priority to domestic support obligations.

Additionally, state claims should be given parity of treatment with federal claims in bankruptcy proceedings.

Lastly, the right of states to establish their own exemptions under state bankruptcy law must be preserved.

PREVENT ABUSE OF CHAPTER 7 BANKRUPTCY FILINGS

Chapter 7 bankruptcy provides a vital mechanism to ensure that debt-ridden individuals have a chance to gain a fresh start. However, Chapter 7 filings have also been increasingly abused by irresponsible consumers seeking to avoid paying their creditors the debts they legitimately owe. Individuals who are capable of repaying part or all of their debts should be required to file Chapter 13 instead of Chapter 7. Otherwise, creditors and responsible consumers who fulfill their moral obligations to pay their debts will continue to have to pay the bill for those who abuse the system, in the form of higher prices, higher borrowing costs, and reduced credit availability.

Page 390 PREV PAGE TOP OF DOC

INCREASE THE PRIORITY OF DOMESTIC SUPPORT OBLIGATIONS

Increasing the priority of domestic support obligations in bankruptcy proceedings is a critical issue for states and the intended recipients of these payments. Congress has given states the primary responsibility for ensuring that noncustodial parents pay child support and other domestic support obligations. States have simultaneously increasingly responsible for the welfare costs that arise when these payments are not collected. Under the current system, bankruptcy proceedings substantially interfere with states' ability to collect child support and assist the intended beneficiaries of these payments. Not only do the costs of state-operated welfare programs increase when states cannot collect child support, but more importantly our most vulnerable citizens suffer. Accordingly, the governors urge you to ensure that any bankruptcy reform legislation requires that domestic support obligations have the highest possible repayments priority in bankruptcy proceedings.

TREAT STATE AND FEDERAL CLAIMS EQUALLY

We also encourage you to address the current disparity in the treatment of federal and state claims in bankruptcy proceedings. Today, bankruptcy appropriately gives preferences in payment to federal claims against the bankruptcy estate, and equivalent treatment should be given to state claims. Additionally, bankruptcy proceedings make it unnecessarily difficult for states to assert valid claims. States frequently have difficulty obtaining notice of bankruptcy proceedings, adversely affecting their ability to participate in these proceedings and to collect unpaid taxes. Governors accordingly support efforts to treat state and federal claims equally and to provide better notification about bankruptcy proceedings to states.

Page 391 PREV PAGE TOP OF DOC

PROTECT THE STATE ROLE: PRESERVER HOMESTEAD EXEMPTIONS

Protecting the state role in bankruptcy proceedings is the last issue I am going to talk about today, and it is very important to the nation's governors and the citizens of our states. We strongly oppose efforts to preempt state authority to determine exemptions under state bankruptcy law. In particular, states' rights to determine the standards for homestead exemptions must be preserved. Uniform federal regulations cannot possibly address the different needs and circumstances of individual states. Although imposing a uniform cap on the homestead exemption might have a minimal impact in some states, it would have terrible consequences in others.

Retirees in Florida, for example, who bought their homes many years or even decades ago could be forced out of their homes, which may have double, quadrupled, or even increased ten-fold in value over the years. This would result in considerable turmoil and disruption to their lives at a time when they would already be increasingly vulnerable because of ongoing bankruptcy proceedings. Economic conditions, real estate markets, and other factors vary so widely from state to state that state authority to determine bankruptcy exemptions must clearly be preserved to prevent this kind of disturbing scenario.

Thank you for giving me the opportunity to testify today, Mr. Chairman. The need for bankruptcy reform is clearly pressing. The magnitude of the problem is large enough now during strong economic times that it is discouraging to think how big the problem might become in a less robust economic environment. The nation's governors look forward to working with you this year on bankruptcy reform efforts to ensure that our nation has the strongest, most effective bankruptcy system possible to serve the needs of hard-working, responsible, and honest American families and individuals. March 10, 1999

Page 392 PREV PAGE TOP OF DOC

Hall of the States,
Washington, DC, March 10, 1999.

Hon. **GEORGE W. GEKAS,** *Chairman,*
Hon. **JERROLD NADLER,** *Ranking Minority Member,*
Subcommittee on Commercial and Administrative Law,

Committee on the Judiciary,
House of Representatives, Washington, DC.

DEAR CHAIRMAN GEKAS AND CONGRESSMAN NADLER: Governors support revising federal bankruptcy laws to curb the increasing number of bankruptcy filings in our nation and to stem abuses of the bankruptcy system. At our recently concluded winter meeting, the National Governors' Association approved the attached bankruptcy reform policy that addresses these problems.

Specifically, Governors support federal efforts to prevent debtors from filing Chapter 7 bankruptcy in lieu of Chapter 13 when they are financially capable of repaying part or all of their unsecured debts. We also encourage Congress to ensure that federal bankruptcy reform efforts place the highest possible priority on payment of domestic support obligations, treat state claims against the bankruptcy estate equally to federal claims, and protect the existing right of states to determine their own standards dealing with exemptions.

We look forward to working with you to achieve passage of a bill that achieves these objectives.

Page 393 PREV PAGE TOP OF DOC

Sincerely,

Governor Thomas R. Carper,
Governor Michael O. Leavitt,
Governor George E. Pataki, *Chair*,
Committee on Economic Development and Commerce,
Governor Jeanne Shaheen, *Vice Chair*,
Committee on Economic Development and Commerce.

attachment
c: Senate Committee on the Judiciary and House Committee on the Judiciary

NGA POLICY

EDC–21. BANKRUPTCY REFORM

21.2 Preamble

The Governors support revising federal bankruptcy laws to curb the rapidly increasing number of bankruptcy filings and to better regulate how bankruptcies are conducted. Despite low unemployment and low inflation over the past decade, total bankruptcy filings, including business and nonbusiness filings, have grown from less than 300,000 in 1978. According to the U.S. Census Bureau, consumer or nonbusiness filings alone account for more than 95 percent of these filings, and increased from about 287,000 in 1980 to more than 1.3 million in 1998. The number of business filings remained steady over this same time period.

Page 394 PREV PAGE TOP OF DOC

As bankruptcy becomes an ever-larger factor in our daily life, the Governors are increasingly concerned about its effects. Rapid increases in bankruptcy filings indicate a reduced sense of personal responsibility, which is the basis for our credit economy and our prosperity. Of equal concern, bankruptcy has a very significant impact on state budgets and on all sectors of state economies. The U.S. Census Bureau estimates that amounts involved in the bankruptcy proceedings of some of the largest U.S. corporations are more than $8 billion. Other estimates show that more than $44 billion in total debt is discharged each year in bankruptcy proceedings, or more than $400 for each U.S. household.

The results are felt in state budgets and in Governors' ability to do what they6 were elected to do. States find it harder to collect from those who file for bankruptcy and are either delayed or sometimes prevented from enforcing state law. Our citizens also feel the results.

Taxpaying creditors are hurt by not being able to collect on loans or credit given in good faith, reducing tax revenues. Consumers face higher interest rates and credit costs, higher retail prices, stricter lending standards, and decreased rates on savings. Small businesses are likewise adversely affected. For example, many small businesses rely upon credit cards and home equity lines for credit. If those types of credit become less available, many small businesses could be forced to borrow at higher rates or be forced to close because they have no financing.

The Governors are particularly concerned that bankruptcy reform legislation address the following issues.

Page 395 PREV PAGE TOP OF DOC

21.2 Prevent Chapter 7 Use by Those with the Ability to Pay

Chapter 7 was originally intended to be a way for honest, hopelessly debt-burdened individuals to gain a fresh start. However, Chapter 7 often has been abused over the last two decades as a way for consumers to irresponsibly avoid paying their creditors. Present bankruptcy law does not prevent use of Chapter 7 by those with the ability to repay, nor does it require that debtors use Chapter 13, which would require them to repay creditors what the debtor can afford. Increasingly, people who should be able to pay some or all of their debts under Chapter 13 are filing Chapter 7 bankruptcy to avoid their responsibilities and impose on others the costs of their doing so.

This practice hurts the states as much as it hurts those who pay their debts and their creditors. When debtors do not pay what they owe, states simply forego revenue from discharged debts.

The Governors strongly support federal efforts to prevent debtors from using Chapter 7 when they are financially able to pay some or all of their unsecured debts. Various ability-to-pay tests could be used to determine which debtors should be compelled to file under Chapter 13 as opposed to Chapter 7. Previous attempts to control this abuse have been thwarted by unclear legislative language and an unwillingness by those who administer the bankruptcy system to enforce existing laws. Federal efforts to prevent abuse should be carefully designed to ensure effectiveness.

21.3 Encourage Payment of Domestic Support Obligations

Page 396 PREV PAGE TOP OF DOC

Congress has imposed upon the states the primary responsibility for ensuring that noncustodial parents pay child support and certain other domestic support obligations, and great strides have been taken over the last several years to create an effective child support system, administered by the states. At the same time, the states have increasingly become responsible for the welfare costs that arise when child support and similar obligations are not collected.

Today, bankruptcy interferes significantly with states' ability to assist citizens owed domestic support and to collect unpaid domestic support owed them when they have paid a custodial parent public assistance to replace unpaid support. When states cannot collect child support, some of their most vulnerable citizens may suffer the consequences at the same time that the costs of state-operated welfare programs increase.

The Governors strongly encourage Congress to ensure that any federal bankruptcy reform requires that domestic support obligations have the highest possible repayment priority, that all domestic support obligations be nondischargeable, and that commencement of bankruptcy not prevent the continued collection of child and other support obligations. In addition, any reform should require that the availability of any discharge or the confirmation of any plan be conditioned upon the debtor having made all post-petition payments toward domestic support obligations, that a debtor not be able to hide behind exemptions to avoid payment of domestic support obligations, and that a payment of domestic support be free from attack by the bankruptcy trustee as a preference.

21.4 Give State Claims Parity with Federal Claims in Bankruptcy

Page 397 PREV PAGE TOP OF DOC

Today, bankruptcy rightly gives certain preferences in payment to federal claims against the bankruptcy estate, but similar treatment is not always accorded state claims. These claims can involve unpaid taxes and other claims.

At the same time, bankruptcy makes state assertion of valid claims unnecessarily problematic. States have difficulty obtaining notices of bankruptcy proceedings, adversely affecting their ability to participate in proceedings, particularly with respect to collection of unpaid taxes.

The Governors strongly support congressional efforts to reform the treatment of state claims in bankruptcy to provide parity of treatment of federal claims, reduce nondischargeability of tax obligations, provide better notice, and improve procedural treatment of state claims.

21.4 Protect the State Role

The issue of bankruptcy reform needs to be addressed by states, not only to protect the rights of citizens and state budgets, but also to defend states' rights to determine their own standards. The Governors oppose efforts to preempt state authority to determine exemptions under state bankruptcy law. Currently, debtors have a right to choose between federal and state exemptions. Most choose state exemptions when they are more lenient towards the debtor. States can also prevent debtors from using federal exemptions. More than 50 percent of the states have elected to bar their residents from using federal exemptions. The Governors support efforts to shape bankruptcy reform policy that protects the rights of states to determine their own standards instead of having uniform federal regulations imposed without regard for individual state needs.

Page 398 PREV PAGE TOP OF DOC

Time limited (effective Winter Meeting 1999—Winter Meeting 2001).
Adopted Winter Meeting 1999.

Mr. **GEKAS.** I want you to know that when I embarked on this process last term, one of the startling items to me was the loss of tax revenues by local governments, State governments and Federal Governments that had run rampant for a generation in the bankruptcy world. I was startled by that. I didn't realize it.

As a result of what we learned, what we did in the legislation last year and we recapitulated now in this bill does give the notification features, more ability on the part of local governments to receive some of the revenue that was due them.

Why is it important? You have stated, not just because the State and the local governments need it, which they always do, but to the extent that they fail to recover, the rest of the taxpayers have to make up the difference, and the legislature has to recover, et cetera. So that is important for us to have heard that from you directly here today, and I am very appreciative of that.

On the other points that you made—I just want to ask one question. You hope that, as we all do, that this will find a sound ear in the White House, eventually. Does the Governors' Association plan to lobby for bankruptcy reform in an acceptable form that the conference might come up with with the White House? If you don't have plans to do that, I am asking you to make plans to do that.

Page 399 PREV PAGE TOP OF DOC

Mr. **CARPER.** The way the National Governors' Association works, we develop policy largely on consensus; and, by consensus, I mean 50 governors for the most part signing off on policy—Democrats, Republicans, and now we have a couple of Independents as well. And we have hammered out policy over the years and met here in Washington just about 3 weeks ago, and we addressed policy in a variety of issues.

One of the areas that we addressed was bankruptcy reform, and we came to a consensus without any dissent with respect to NGA policy as it pertains to bankruptcy reform. And, as a result, I am here today to put that policy forward.

Mr. **GEKAS.** I understand. But I recall very well, Governor, that several years ago, the Governors' Association played a magnificent role in convincing the White House as well as congressional leaders of the need of certain types of welfare reform, of which 97 percent found its way into law. Part of that was because the Governors' Association was able, in my judgment, to convince the White House that indeed the time had come for it.

And I am asking you, I am imploring you to use the same devices, good devices, to see that the White House learns of your position.

Mr. **CARPER.** Three years ago when we came out of our—finished up our NGA winter meeting, I was then the lead Democratic governor on welfare reform. John Engler, Republican, was the lead Republican governor. We developed a kind of consensus that we are talking about on welfare reform and came to the Capitol and to the White House, and we said we agree on this, all 50 of us.

Page 400 PREV PAGE TOP OF DOC

With respect to the bankruptcy policy, the points I addressed today are all points we agree on, 50 of us; and we are going to be lobbying actively on the House and the Senate side and in the White House as well. In fact, we have already begun.

Mr. **GEKAS.** You have made my day. I heard somebody say that one time. And you really have. I thank you very much.

Does the gentleman from North Carolina have any questions?

Mr. **WATT.** No, Mr. Chairman. I don't have any questions. Thank you, Governor, for being here.

Mr. **CARPER.** Nice to see you here.

Mr. **WATT.** And thank him for his presentation.

Mr. **GEKAS.** We thank you very much, and we excuse you with our gratitude.

This committee stands in recess until 1:25.

[Recess.]

Mr. **GEKAS.** The hour of 1:25 having arrived, the committee will come to order.

Page 401 PREV PAGE TOP OF DOC

Noting the absence of a hearing quorum, we will take the necessary steps to bring the panel to the witness table and do the formal introductions and then await the arrival of another member so that we can be legitimate in hearing their actual testimony.

First to be introduced would be the Honorable Randall J. Newsome, United States Bankruptcy Judge for the Northern District of California.

He first served as a bankruptcy judge in the Southern District of Ohio from 1982 to 1988. He thereafter was appointed a bankruptcy judge for the Northern District of California. He has served as a visiting bankruptcy judge in the Western District of Washington, the District of Arizona and the Central District of California.

Judge Newsome obtained his bachelor of arts degree from Boston University in 1972 and his juris doctor degree from the University of Cincinnati in 1975. He is currently President of the National Conference of Bankruptcy Judges.

With him at the witness table is Robert H. Waldschmidt, who has served as a bankruptcy trustee since 1976 and has been a member of the Chapter 7 Trustee Panel for the Middle District of Tennessee since 1979.

Mr. Waldschmidt's practice, as a member of the Nashville, Tennessee, law firm of Howell & Fisher, concentrates on commercial law and bankruptcy. He regularly represents creditors, debtors, creditors' committees and trustees under chapters 7, 11 and 13 of the Bankruptcy Code.

Page 402 PREV PAGE TOP OF DOC

In addition to the National Association of Bankruptcy Trustees, on whose behalf he appears here today, Mr. Waldschmidt is a member of the American Bar Association, the Commercial Law League of America and the Nashville Bar Association.

A graduate of Vanderbilt Law School where he received his J.D., Mr. Waldschmidt previously attended Hillsdale College where he received his B.S. in mathematics, summa cum laude.

And Henry E. Hildebrand, III, Standing Chapter 13 Trustee for the Middle District of Tennessee since 1982. He is also the managing partner in the Nashville law firm of Lassiter, Tidwell and Hildebrand.

Mr. Hildebrand graduated from Vanderbilt University and the National Law Center of George Washington University. He is chairman of the Legislative Affairs and Industry Standards Committees for the National Association of Chapter 13 Trustees. He also serves on the Consumer Bankruptcy Subcommittee of the American Bar Association's Business Law Committee, as well as on the Consumer Bankruptcy Committee of the American Bankruptcy Institute.

Mr. Hildebrand is board certified in consumer bankruptcy law by the American Bankruptcy Board of Certification, where he also serves on its board of directors.

As I indicated, we will have to be patient until the arrival of another member so that we can be legitimatized.

Page 403 PREV PAGE TOP OF DOC

In having read the testimony previously of all the panelists, some of the questions that will be posed will be pursuant to my recollection of what I read and may not touch on what you orally present today.

But just to forewarn, Judge Newsome, for instance, on page 6 of his testimony at the bottom, he says that real reform of the bankruptcy system will only arrive when those who make statements under oath in their bankruptcy filings are held to account for them. I would want to touch upon that.

Mr. **NEWSOME.** Okay.

Mr. **GEKAS.** Now noting the arrival of the gentleman from North Carolina, Mr. Watt, it constitutes the hearing quorum necessary to proceed.

We will begin with the testimony of Judge Newsome. The statements will be made a part of the record. The oral presentations should restrict itself to 5 minutes, more or less. And we may proceed.

STATEMENT OF RANDALL J. NEWSOME, UNITED STATES BANKRUPTCY JUDGE, NORTHERN DISTRICT OF CALIFORNIA, OAKLAND, CA, ON BEHALF OF THE NATIONAL CONFERENCE OF BANKRUPTCY JUDGES

Mr. **NEWSOME.** Thank you, Mr. Chairman. And thank you for the opportunity to testify here today.

Page 404 PREV PAGE TOP OF DOC

Mr. Chairman, I have just two points to make. The first point is that, while H.R. 833 will probably result in only 3 to 4 percent of chapter 7 filers being dismissed or converted to chapter 13, it will negatively impact the administration of the other 96 percent of the cases or of the debtors who will be allowed to remain in chapter 7.

As I stated in my written testimony, my colleagues, with the help of their clerks' offices and staff, have collected over 5,000 chapter 7 cases in 65 surveys from all over the country. I want to use just one of those cases to demonstrate how H.R. 833 will make it more difficult for honest debtors and everyone to obtain bankruptcy relief.

This 1998 case was filed in the Central District of Illinois. The debtor lives in Monticello, Illinois, a small town about 40 miles from Decatur and 30 miles from Champaign. Having reviewed and analyzed about 15 of these surveys myself, I can tell you that this case is not unusual; and, indeed, it is pretty typical of what I see every day.

The debtor is retired and apparently living solely on a Social Security income of $657 a month. She lists $18,779 dollars in debt on her five credit cards and $2,959 on her two retail credit cards. She is, in a word, irrevocably insolvent. She is among the some 2,700 of our 3,151 1998 chapter 7 cases that wouldn't have to worry about means testing if H.R. 833 had been in effect when she filed.

But she, along with everyone who files a consumer bankruptcy, will have plenty of other problems to worry about if H.R. 833 becomes law.

First, she would have to obtain credit counseling within 90 days prior to filing or, if she has a good excuse, within 30 days after she files and file a certificate evidencing that she did so as well as any repayment plan she could come up with.

Page 405 PREV PAGE TOP OF DOC

Now, assuming she knows she has to go to an approved credit counselor and assuming that she has been told about this credit counseling requirement at all, she is going to have to drive 30 to 40 miles, probably, to get the credit counseling, unless the U.S. trustee designates her district as a place where it is not available. But assuming she goes to the approved credit counselor, what are they going to talk about? To repeat, she has got $21,739 in unsecured debt, and she makes $7,884 in yearly income. Her monthly expenses exceed her monthly income by any measure.

Why are we burdening her with credit counseling? A little financial management instruction back in high school might have helped her stay out of financial trouble, but no amount of instruction is going to help her now. The money is gone, and she can't pay it back.

The next thing she is going to have to do is dig out 3 years of tax returns and file with them with her bankruptcy petition. What if she never filed any tax returns because she didn't have to? Or what if she has filed them electronically and thus doesn't have a hard copy of them?

Nevertheless, if she doesn't file them, the case gets dismissed automatically under section 604 of H.R. 833.

Now, in addition to meeting these new filing requirements and in addition to all the other documents she must file under present law, she will also be required to file a statement of projected monthly income, a statement disclosing any anticipated increases in income over the next 12 months, any tax return she files after the case is commenced and until it is closed, and a statement of calculations under the means test, all for a woman who makes $657 a month from Social Security.

Page 406 PREV PAGE TOP OF DOC

Do we really want to put this senior citizen through all of this? Do we really want to put the other 800,000 chapter 7 filers who fall under the median income standards in the bill and who would not be affected by the means test through all of this? All so we can catch 3.6 percent who may be pushed into chapter 13?

My other point also relates to the findings from our surveys. For the 3,151 cases in the surveys that were filed in 1998, the median income for all households was $21,540. The median amount of unsecured nonpriority debt for all households was $23,411. Given these income and debt levels, there is no basis for suggesting that H.R. 833 will decrease the level of filings. You can make it a lot harder for people to get bankruptcy relief, but they will still file for bankruptcy, because they have no other reasonable option.

Mr. Chairman, I submit to you, and this I am stating on my own behalf only, that there is a cheaper and more effective way to achieve real bankruptcy reform; and I would be glad to answer any questions after the other panelists have testified.

Mr. **GEKAS.** Yes. We thank the judge.

[The prepared statement of Judge Newsome follows:]

PREPARED STATEMENT OF RANDALL J. NEWSOME, UNITED STATES BANKRUPTCY JUDGE, NORTHERN DISTRICT OF CALIFORNIA, OAKLAND, CA, ON BEHALF OF THE NATIONAL CONFERENCE OF BANKRUPTCY JUDGES

SUMMARY

Page 407 PREV PAGE TOP OF DOC

A review of 65 surveys of chapter 7 cases from 46 judicial districts in 33 states reveals that the median gross annual income for the 3151 cases filed in 1998 is $21,540, some $15,000 lower than the 1997 national median income for all families in the United States. Approximately 15% of the families in the 3151 cases had gross annual income equal to or greater than the median income for all U.S. households as of 1997. But according to another recent study, only about 3.6% of all chapter 7 cases would actually be subject to conversion to chapter 13 or dismissal under a substantially similar means test. The end result would be that about 96.4% of chapter 7 filers would be required to do significantly more paperwork at additional cost to net the 3.6% of the cases that might pay creditors something in a chapter 13 case.

H.R. 833 probably will not affect the current level of filings, since the data from 3151 cases filed in 1998 indicates that the median amount of unsecured nonpriority debt is $23,411. With an overall median income of only $21,540, it is evident that most of the debtors surveyed are hopelessly insolvent, and that bankruptcy is their only realistic option.

A review of all 5235 chapter 7 cases in the 65 surveys indicates that the average age of all automobiles and pick-up trucks reported is about 1989. Given the age of their cars, and the fact that the means test allows a deduction for secured debts, debtors will have a strong incentive to buy a car on the eve of bankruptcy to raise their secured debt payments and thus avoid chapter 13.

At least 16 potential sources of litigation are embedded in the means-testing provisions of H.R. 833. Another 42 litigation points have been identified in the other consumer provisions of the bill. This is probably only the tip of the iceberg. Given these new wellsprings of disputes, the bankruptcy courts are at serious risk of being overwhelmed with litigation. Administration of H.R. 833 almost surely will require significantly more judges and other resources.

Page 408 PREV PAGE TOP OF DOC

Bankruptcy reform need not be this complex and expensive. There is a simpler and more efficient way to accomplish our common goal of providing debt relief to those who truly need it, while eliminating abusers from the system.

STATEMENT

Mr. Chairman and distinguished members of this Subcommittee, I am honored to testify once again regarding the important subject of bankruptcy reform. By way of background, I have been a bankruptcy judge in the Northern District of California sitting in Oakland since May of 1988. From October, 1982 until May, 1988 I was a bankruptcy judge in the Southern District of Ohio sitting in Cincinnati. I became president of the National Conference of Bankruptcy Judges in October of 1998. Unless otherwise noted herein, I am speaking on behalf of the NCBJ and all 319 of its members.

Ever since its formation in 1926, the National Conference of Bankruptcy Judges has sought to be an independent, neutral source of information regarding the administration and substance of the bankruptcy laws in this country. We do not presume to tell Congress what is sound or unsound policy, or to make value judgments about proposed legislation. Rather, we endeavor to analyze legislative proposals and offer information regarding their probable effects and impact upon the bankruptcy courts and bankruptcy administration generally.

As I stated in my testimony before this Subcommittee almost exactly one year ago, everyone involved in bankruptcy reform has been hampered by the lack of reliable information about bankruptcy debtors and their families. The empirical void is far from being filled, but some progress has been made in developing a portrait of the typical consumer debtor. I made a small contribution to this cause by putting together a survey of 100 chapter 7 cases in Oakland. That survey was appended to my testimony before you last year.

Page 409 PREV PAGE TOP OF DOC

In November of 1998 I asked all of my colleagues to conduct exactly the same survey on 100 randomly-selected chapter 7 cases closed within the last year in their districts. The response to my request was most gratifying. By January of this year I had received 65 surveys from 46 different judicial districts in 33 different states. Although most of the surveys are of 100 cases, they range in size from 20 cases to 400. The resulting database consists of some 42 categories of information in approximately 5235 chapter 7 cases. We view this data as being in the public domain, and will provide a copy of it to anyone who seeks it.

Professor Gary Neustadter of the Santa Clara University School of Law graciously agreed to undertake the task of reviewing and analyzing this information. Given the sheer volume of data, time has not permitted him to compile results for every category of information. But the numbers he has been able to glean from the data (attached as Exhibit 1) in the short time available warrant caution in engrafting the means test in H.R. 833 upon the bankruptcy system.

Based upon his review of the 3151 cases filed and closed in 1998, Professor Neustadter found that the median gross annual income for those cases was $21,540, over $15,000 lower than the median income for all U.S. households as of 1997.(see footnote 19) Approximately 15% of the families in the 3151 cases had gross annual income equal to or greater than the national median income for families of the same size. This number is significant in the context of H.R. 833's means test. Under that test, the panel trustee may file a motion to convert or dismiss a case if the debtor can pay 25% or $5000 in a chapter 13 plan over 5 years, but the trustee *must* file a motion only if the debtor's income exceeds certain national median income levels. *See* Section 102(b)(2). Furthermore, creditors may file motions under this section only as to those who are over the national median household income levels. Thus, the 15% number defines the universe of potential cases which will draw heightened scrutiny by the trustee and creditors, and possibly result in a mandatory motion for presumed abuse. In raw numbers, that means that the bankruptcy courts potentially could be embroiled in disputes over the means test in at least 150,000 cases based on 1998 filings (*i.e.*, 15% times approximately 1,000,000 chapter 7 consumer filings). But according to Professors Marianne B. Culhane and Michaela M. White in "Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors," (to be published in the next edition of the American Bankruptcy Institute Law Review), only about 3.6% of all chapter 7 cases would actually be subject to conversion to chapter 13 or dismissal under a means test very similar to that of H.R. 833.

Page 410 PREV PAGE TOP OF DOC

To summarize, the means test and other provisions of H.R. 833 would require 85% of chapter 7 filers to complete and file an additional 7 or more sets of forms and documents beyond what they are required to file now(see footnote 20), even though they probably would not be subject to a motion to convert or dismiss under section 707(b). Another 15% might be subject to a mandatory section 707(b) motion, but ultimately such motions would be granted in only 3.6% of all the chapter 7 cases filed. Thus, the means test in H.R. 833 will substantially increase the expense and red tape of filing a bankruptcy for the overwhelming majority who deserve relief, but will net only a tiny number of abusers. There may be some justification for imposing this bureaucratic and financial burden on some chapter 7 debtors, but is there much to be gained by so burdening those who have filed because of crushing medical debts, or those who are struggling as single parents, or those who are disabled or retired? As Exhibit 2(see footnote 21) illustrates, a significant number of the over 5000 chapter 7 debtors surveyed fall into each of these categories. The number of debtors with over $1000 in medical debt is especially striking, particularly in rural areas.

1. certificate of notice under §342(b);
2. copies of federal tax returns and all attachments for the preceding 3 years;
3. copies of all pay stubs for the previous 60 days;
4. statement of projected monthly income, itemized to show how calculated;
5. statement disclosing any reasonably anticipated increase in income or expenditures over the next 12 months;
6. federal tax returns and any amended returns filed after the case is commenced and before it's closed.

Page 411 PREV PAGE TOP OF DOC

With the exception of number 6, failure to file the above within 45 days results in automatic dismissal under section 604. In addition, section 302(a) requires the debtor to file a certificate of credit counseling and a debt repayment plan, and section 102 requires that a statement of current monthly income and calculations under the means test be included in the schedule of current income and expenditures.

One of the stated goals of H.R. 833 and other recent bankruptcy reform proposals is to stem the tide of increased bankruptcy filings. A review of our data casts doubt on whether H.R. 833 will have this effect. The surveys indicate that the level of unsecured indebtedness is so great in most cases that most debtors have no other realistic option but to seek bankruptcy relief. As Exhibit 1 indicates, the median amount of unsecured nonpriority debt for the surveys' 3151 chapter 7 cases filed in 1998 is a staggering $23,411. With an overall median income of only $21,540, it is apparent that most of these debtors are hopelessly insolvent. Although some instruction in financial management might have helped some of these people avoid their financial plight, it seems doubtful that credit counseling on the eve of bankruptcy would have done anyone much good given these debtors' income and debt levels.

Because the means test in H.R. 833 allows debtors to deduct "all amounts scheduled as contractually due to secured creditors," some have predicted that debtors will engage in pre-bankruptcy planning by purchasing a car to raise their secured debt payments, thus avoiding chapter 13. Given the age of the automobiles in these 65 surveys, these predictions appear to be well-founded. The average model year of the cars and pick-up trucks listed in all chapter 7 cases was about 1989. *See* Exhibit 2.(see footnote 22) Most of the cases surveyed were filed in 1998, and almost all of the cases were filed in 1996 or thereafter. Thus, many of these people own cars that are more than 7 years old and are ready or overdue for replacement. Given the age of their cars, as well as the absence of any specific car replacement allowance in the IRS standards, debtors would have every incentive to purchase a new car before filing their bankruptcy petitions. That incentive is heightened for the substantial number of debtors who own no car at all.

Page 412 PREV PAGE TOP OF DOC

H.R. 833's means test also risks overwhelming the bankruptcy courts with disputes over its particulars. As attached Exhibit 3 indicates, I have identified 16 areas of potential litigation in section 102 of the bill alone. Many of the issues raised are factually intensive, and will recur in the thousands of potential motions that might be filed pursuant to the means-testing provisions.

In addition to the 16 litigation points embedded in section 102, Exhibit 3 lists another 42 issues that potentially may require bankruptcy court intervention for their resolution. Again, many of these issues will come before the court repeatedly. For example, section 119 of H.R. 833 limits the automatic stay to 30 days for some repeat filers and eliminates it altogether for others. Bankruptcy judges will be required to set a new calender (probably every week) for motions to extend the stay or to impose a stay under this section. Section 129, which gives creditors the right to challenge the dischargeability of certain debts in chapter 13 cases, almost certainly would increase the number of dischargeability lawsuits significantly. These types of lawsuits already make up a large percentage of our adversary proceeding calenders.

Exhibit 3 identifies only 58 new litigation points in H.R. 833. I'm sure I have overlooked many others. Some of these issues may arise infrequently; some of them undoubtedly will arise almost every day; some may be resolved without the need for a hearing; others will require a full-blown trial. Taken together, however, I have no doubt that the increased litigation arising from H.R. 833 will strain the resources of our bankruptcy courts, many of which are already struggling to keep up with the workload. The Congressional Budget Office's estimate of 15 to 30 additional judgeships(see footnote 23) being required under one of H.R. 833's predecessors may need to be revised upward.

Page 413 PREV PAGE TOP OF DOC

The misgivings I've expressed about the effects of H.R. 833 should not be interpreted as a wholesale rejection of the need for bankruptcy reform. As I emphasized in my remarks to you last year, if there's one thing every bankruptcy judge would agree upon, it is that there are abuses occurring in the bankruptcy system. Although abuse is not nearly as pervasive as some have suggested, bankruptcy judges witness it all too frequently. We are frustrated not by the absence of laws to address abuses, but by the lack of enforcement of those laws, particularly the bankruptcy criminal statutes (18 U.S.C. §151 et seq.) and Title 18 of the United States Code generally. Real reform of the bankruptcy system will only arrive when those who make statements under oath in their bankruptcy filings are held to account for them. That accountability simply doesn't exist at present, and no amount of additional paperwork will foster it.

Speaking solely on my own behalf, and not on behalf of the NCBJ, I believe there is a simpler, more effective, less costly way to achieve reform that would require relatively little change in the law. Instead of subjecting everyone to the means-testing gauntlet, the process could be greatly simplified by *requiring* the United States trustee to review every consumer chapter 7 case, and *requiring* the United States trustee to file a motion under section 707(b) if the debtor could pay more than 25% of his unsecured nonpriority debts or if the chapter 7 case was filed in bad faith. The United States trustee's inquiry would be guided not by rigid and unrealistic IRS standards, but rather by common sense and perhaps some flexible guidelines. Having reviewed fifteen of these case surveys myself, I can assure you that the few potential abusers in each survey are not that difficult to identify. Creditors and other parties in interest would be given the opportunity to file a section 707(b) motion if the debtor made significantly more than the national median income.

Page 414 PREV PAGE TOP OF DOC

This is precisely the sort of task envisioned for the United States trustees when the program was created in 1978.(see footnote 24) Unfortunately, the program has never been adequately funded to perform all of the duties assigned to it. Although the United States trustees do review chapter 7 cases and file motions under the present version of section

707(b), it is only one of their discretionary duties, not a mandatory one.(see footnote 25)

The United States trustee program has also suffered from not having the cabinet-level leadership promised in 1978. As a part of the Bankruptcy Reform Act of 1978, Congress authorized an Assistant Attorney General position in the Department of Justice to head up the United States trustee program. That position was never used as originally intended. At present, the program is headed by a Director of the Executive Office of the United States Trustee, a position which the statute only references in passing.(see footnote 26) Although the present Director, Mr. Joseph Patchen, has performed admirably, the position lacks the authority to prescribe and enforce uniform policies nationwide where needed. Authorization for an Assistant Attorney General to provide that authority and leadership would constitute a major step towards realizing the full potential of the United States trustee program—and a major step towards real bankruptcy reform.

To complement the United States trustees' mandatory responsibility for policing the system, the newly-created Assistant Attorney General should also be given primary responsibility for the prosecution of federal crimes arising in or related to bankruptcy cases. That authority could be folded into the operations of the local United States Attorneys by providing that Special Assistant United States Attorneys be assigned to work in each regional United States trustee office. National strike forces could also be established if needed to pursue particular kinds of bankruptcy crimes.

Page 415 PREV PAGE TOP OF DOC

Obviously, the Assistant Attorney General for Bankruptcy Administration and the United States trustees will require additional funding for personnel and other resources to properly carry out their mandatory section 707(b) duties and prosecutorial functions. All of the money needed to fund these new operations is already available in the bankruptcy system. In order to fund their operations, the chapter 13 trustees are authorized to collect up to 10% in commissions from all the funds they distribute to creditors. At present, the average chapter 13 trustee is charging approximately 5.6%(see footnote 27). In all likelihood, only an additional 1% to 2% in chapter 13 trustee commissions would be necessary to fund the entire bankruptcy reform package.

Bankruptcy reform need not be as complicated or as costly as that proposed in H.R. 833. The provisions suggested above, along with modest changes to address problems such as abusive repeat filers, would provide all of the reform the system requires. Thank you again for giving me this second opportunity to appear and be heard before this Subcommittee.

EXHIBIT 1

63593j.eps

63593k.eps

63593l.eps

63593m.eps

Page 416 PREV PAGE TOP OF DOC

63593n.eps

63593o.eps

63593p.eps

EXHIBIT 2

63593q.eps

63593r.eps

63593s.eps

63593t.eps

63593u.eps

63593v.eps

63593w.eps

EXHIBIT 3

Page 417 PREV PAGE TOP OF DOC

HOW THE CONSUMER PROVISIONS OF H.R. 833 WILL INCREASE THE BANKRUPTCY COURTS' WORKLOAD: A LIST OF MAJOR NEW LITIGATION POINTS

(ISSUES IN ITALIC PRINT ARE EXPECTED TO OCCUR)

Section 102—Dismissal or Conversion

1. If a joint petition is filed by the debtor and his spouse, but the debtor and his spouse are separated and are maintaining two separate households, are they entitled to twice the amount of the IRS guidelines, or are they limited to the amount they would receive if they were not separated?

2. Since utilities are lumped together with housing expense in the IRS standards, how should this standard be applied?

3. Do the debtor's expenses fall the category of "Other Necessary Expenses?"

4. Is the "Other Necessary Expenses" standard one that has actually been "issued by the IRS" as prescribed by the statute, or is it a non-issued, internal agency standard?

5. In determining "Other Necessary Expenses," must the court follow Chapter 3 of IRS Handbook 105.1, which describes how this standard is to be applied? If so, is the court governed by the entire handbook, or only portions thereof?

6. Does a plain reading of the statute entitle the debtor to deduct both his actual mortgage payment as well as the IRS Housing and Utililty Standard amount?

Page 418 PREV PAGE TOP OF DOC

7. Does a plain reading of the statute entitle the debtor to deduct mortgage payments for nonresidential real estate, such as rental units and vacation homes?

8. Does a plain reading of the statute entitle the debtor to deduct secured payments for all motor vechicles, including jet skis, motor boats, RVs, motorcycles, etc.?

9. Assuming a presumption of abuse exists, has the debtor rebutted the presumption by establishing extraordinary circumstances?

10. Does the definition of "current monthly income" mean that a married debtor whose spouse does not file with him need not include the spouse's income for purposes of the means test calculation?

11. Does the definition of "current monthly income" mean that a married debtor who is separated from his spouse but who files a joint petition under chapter 7 with his spouse must include the spouse's income for purposes of the means test calculation, even if the spouse is maintaining a separate household?

12. Even if the presumption of abuse does not apply or has been rebutted, should the debtor's case be dismissed or converted because it was filed in bad faith or is otherwise abusive?

13. If the panel trustee prevails on a §707(b) motion and the court finds that the chapter 7 filing was not substantially justified, what amount of fees should the debtor's attorney be required to pay?

Page 419 PREV PAGE TOP OF DOC

14. If the court finds that the debtor's attorney violated Rule 9011 in filing the case under chapter 7, what civil penalty should the court impose?

15. If the court denies the §707(b) motion, should the creditor be required to pay the debtor's attorneys' fees because:

a. the motion was not substantially justified; or

b. the motion was brought solely to coerce the debtor?

16. Be referring to "national median household monthly income" as a limitation for §707(b) motions being brought by creditors, is the statute referring to the category of U.S. Census Bureau numbers for households based upon the size of the household, the number of earners in the household, some combination of the two, or neither of the two?

Section 108—Enforcement

1. Has a debt relief agency failed to comply with new sections 526 and 527, or negligently failed to file bankruptcy papers resulting in dismissal of the bankruptcy, or disregarded the applicable law?

2. Should a debt relief agency be enjoined for failing to comply with sections 526 and 527:

Page 420 PREV PAGE TOP OF DOC

a. If the suit against the debt relief agency is successful, what fees should be awarded to the successful party?

b. If the debt relief agency intentionally violated sections 526 and 527, what civil penalty, if any, should be imposed?

Section 111—Promotion of Alternative Dispute Resolution

1. Has the debtor proved by clear and convincing evidence that a creditor unreasonably refused to negotiate a reasonable alternative repayment schedule or refused to consider the debtor's proposal?

2. Was the offer made by an "approved" credit counseling agency?

3. Must the offer be in writing?

4. Was the offer made at least 60 days prior to filing a bankruptcy petition?

Section 115—Protection of Savings Earmarked for the Postsecondary Education of Children?

Does paragraph (5)(B) of this statute mean that a debtor with *less than* $50,000 in accounts for each child is not entitled to the exemption?

Section 116—Effect of Discharge

Page 421 PREV PAGE TOP OF DOC

1. Has the creditor engaged in a willful failure to credit payments received under a chapter 11 or 13 plan:

2. What sorts of injuries arising out of a failure of the creditor to follow reaffirmation requirements does the statute contemplate?

Section 119—Discouraging Bad Faith Repeat Filings

1. If a motion to extend the 30-day period under new section 362(c)(3) and (4) is filed near the 30th day, does the court have the authority to extend or impose the stay beyond the 30-day period to allow the creditor to be given adequate notice of the hearing?

2. Should the court extend the 30-day stay on an interim basis under new section 362(c)(3) for as long as is required to give the creditor adequate notice of the debtor's motion?

3. Should the court impose a stay on an interim basis under new section 362(c)(4) for as long as is required to give the creditor adequate notice of the debtor's motion?

4. Has the debtor met his burden of proving that the second filing within one year was filed in good faith under section 362(c)(3), and if so, how long should the stay be extended?

5. If the case was presumptively filed in bad faith under section 362(c)(3), has the debtor established clear and convincing evidence to rebut the presumption, and if so, how long should the stay be extended?

Page 422 PREV PAGE TOP OF DOC

6. Given that section 362(c)(4) applies where there have been 2 or more previous filings, when would the presumption ever arise under §362(c)(3)(A)(i), since it refers to "more than one previous case . . . pending within such 1-year period"?

7. Has the debtor met his burden of proving under section 362(c)(4) that his third or more riling within one year was filed in good faith, thus justifying the imposition of a stay?

Section 121 and 122

1. Should the court, pursuant to the riling of an adversary proceeding under section 105, grant an injunction preventing the creditor from taking possession of the debtor's personal property, where the debtor has failed to redeem it, enter into a reaffirmation agreement with the creditor, or assume the lease within the requisite 45-day period?

2. Should the court grant the trustee's motion to prevent the creditor from taking possession of the property?

3. Did the stay not lift under new section 362(h) because the creditor refused "to reaffirm on the original contract terms?"

Section 124—Restraining Abusive Purchases on Secured Credit

If a chapter 13 case is filed in the fifth year after personal property subject to a purchase money security interest is acquired, and the case is dismissed the year after, would the debtor be bound to the same contract terms under new section 506(e)(2) if he filed a second chapter 13 within the 2-year period of new section 506(e)(4)?

Page 423 PREV PAGE TOP OF DOC

Section 129—Discharge under Chapter 13

1. Has the creditor proven by a preponderance of the evidence in its chapter 13 adversary proceeding that its debt is nondischargeable under section 523(a)(2)?

2. Has the creditor proven by a preponderance of the evidence in its chapter 13 adversary proceeding that its debt is nondischargeable under section 523(a)(4)?

3. Has the creditor proven by a preponderance of the evidence in its chapter 13 adversary proceeding that its debt is nondischargeable as a result of willful and malicious injury by the debtor that caused personal injury or death to an individual under section 523(a)(6) and new section 1328(a)(4)?

Section 137

1. Should the court reduce the amount of payments called for under this section to an amount less than the contract amount?

2. Should the court dismiss the debtor's chapter 13 case for failure to make the payments called for under this section?

3. If the case is dismissed for failure to make the payments called for in this section, should that dismissal be set aside?

Page 424 PREV PAGE TOP OF DOC

4. Should the court lift the automatic stay for failure to make the payments called for under this section?

Section 148—Definition of Household Goods and Antiques

1. Given its substantial overlap with other provisions in what is now §522(f)(1)(B)(i), is section 148's definition of household goods intended to supplant §522(f)(1)(B)(i)?

2. Does "kitchenware" include silverware?

3. What constitutes a work of art?

4. What constitutes an antique for purposes of this section?

5. If the item was acquired with the understanding that it is an antique, but in fact it is not, does it nonetheless fit within this exclusion?

6. Does the phrase "acquired as antiques" cover items that were received through inheritance?

7. Even though jewelry is excluded as a household good, is a lien on jewelry nonetheless avoidable to the extent it impairs any exemption as to jewelry?

Section 149—Nondischargeable Debts

Page 425 PREV PAGE TOP OF DOC

Did the debtor incur a debt to pay a nondischargeable debt with the intent of discharging the new debt in bankruptcy?

Section 302—Miscellaneous Improvements

New 109(h)

1. Does the debtor's certificate seeking a waiver of the credit counseling eligibility requirement contain sufficient exigent circumstances?

2. Was the debtor actually unable to obtain credit counseling within five days of requesting it?

3. Is the certificate satisfactory to the court?

4. Notwithstanding the requirement that the debtor obtain credit counseling within 30 days after the petition is riled, does the court have the power to waive the requirement or extend the 30-day period if the debtor is physically or mentally disabled or under other extraordinary circumstances?

New 727(a)(1 1)

Did the debtor fail to complete an instructional course in personal financial management?

Page 426 PREV PAGE TOP OF DOC

New 1328(f)

Did the debtor complete an instructional course in personal financial management?

Section 604

Should the court grant the debtor's motion to set aside the automatic dismissal of his case for failure to rile all documents required by §521?

Mr. **GEKAS.** And we turn to Mr. Waldschmidt for 5 minutes.

STATEMENT OF ROBERT WALDSCHMIDT, ESQUIRE, CHAPTER 7 TRUSTEE, NASHVILLE, TN, ON BEHALF OF THE NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES

Mr. **WALDSCHMIDT.** Mr. Chairman and members of the committee, I would like to thank you for asking me here today.

NABT, on behalf of the chapter 7 trustees, is very interested in maintaining the integrity and effectiveness of the bankruptcy system. We welcome every opportunity to participate in this process.

The role of trustees is a little like a pilot flying an airplane. If we were to decide to fly from Washington to Chicago, we would board an airplane trusting that the airlines and, particularly, the pilot, can navigate the plane to its destination. The pilot doesn't choose the destination. That is chosen by the airlines. But before that pilot takes off, he is going to make sure the plane is in good physical shape and navigational controls are working properly, all safety devices are in place, and the plane has enough fuel to make the trip.

Page 427 PREV PAGE TOP OF DOC

Chapter 7 trustees are a little bit in the same position as pilots in this needs-based proposal. We are the pilots that are being asking to steer this system to its destination; and, much like the pilots, we are very concerned about the mechanics of the system in making sure they are sufficient to accomplish the task and there is enough fuel to keep the trustees going.

Section 102 requires trustees to review all chapter 7 debtors, to certify they are eligible for relief under chapter 7, and they do not exceed the maximum standards which are set forth in that section. Then, if the debtor does not pass this test, the trustees are again required to file motions to dismiss.

I am going back to the airplane analogy. This process needs to be mechanically reviewed to determine that it will, in fact, work.

Are the substantive provisions adequate to effectively prevent certain debtors from filing chapter 7? First, we will talk about that one.

The test for disposable income is not very clear. Now I know you have chosen the IRS guidelines, but there are several factors in disposable income which are not covered by the IRS guidelines—things such as day care, insurance, medical expenses, charitable contributions. As the chapter 13 trustees have noted, this causes a real problem. It is a subjective determination, quite often, to determine whether the debtor meets the disposal income test.

Page 428 PREV PAGE TOP OF DOC

In this case, trustees will be put in the position of making subjective determinations concerning the life-style of the debtor. This is not a very comfortable role for a trustee. We are not used to being in a quasi-judge-like position, but we are going to be asked to make those decisions when we file the eligibility document.

On the same note, the suggestion that the trustee should file this report 5 days before the 341 hearing is not logical. Most trustees learn a great deal about the debtors and their financial affairs through the process of preparing for the 341 hearing and then examining debtors at that hearing. Trustees normally do not know much about the debtors until the 341 hearing is completed and any ambiguities in the schedules have been clarified.

I have no idea why the bill has proposed to require the certification 5 days before the 341 hearing, but I know it would make a lot more sense to have it filed 5 to 7 days after the 341 hearing so the trustees could determine whether there was any problem with the way that the debtors had filled out their schedules, particularly schedules I and J, the income and expenses. I think it would be more effective to the system as well.

The next question is whether the trustees can safely navigate through these provisions without being sued by disgruntled debtors or creditors. Unfortunately, these new provisions are extremely frightening to chapter 7 trustees. If a trustee, who is reviewing sometimes between 20 and 200 cases each month makes a clerical mistake, if their paralegal puts a wrong number on a document and passes it to the trustee for examination, the trustee may file a certification stating that the debtor is eligible for relief under chapter 7, no motion for dismissal be filed, and a discharge will get entered.

Page 429 PREV PAGE TOP OF DOC

Then the creditor comes along and then says the trustee made a mistake and sues the trustee for the entire amount of debt owed to them. This is a situation that is black and white. In most cases, trustees cannot be sued personally unless they really committed gross negligence. But this is black and white. We either messed up or we didn't. And in a case where we transposed a figure or there was a clerical error and we don't file it, the law states that the trustee shall file this document and shall file a motion to dismiss.

If the trustees are going to be the central figure in this needs-based system, they cannot be effective if they are running scared. We believe language is necessary to clarify the exposure of trustees and limit the personal attack of trustees to those acts which are taken outside the scope of their duties or in violation of a court order. This language, which I believe would be noncontroversial, would be a major step in improving the mechanics of a needs-based system.

Finally, I noted that a number of people on the last panel commented that the cost of the system would increase primarily because the trustees would have a lot more work to do. With all due respect to them, I take a little offense with that comment because, right now, the trustees are doing this work for free. We would be doing the extra things which are required under it without any additional costs to the system.

So those statements were not entirely accurate, and that is a problem for us. It is a problem of whether there is enough fuel in the airplane. The trustees at this time, in administering all of the cases under their control, get paid $60 for a typical no-asset case. For this they investigate the debtor, they review the schedules, examine the debtors at the section 341 hearing, value assets with marginal value and file numerous reports.

Page 430 PREV PAGE TOP OF DOC

Most trustees do not profit much from these cases since they have to hire paralegals and other staff to help them administer these cases. The no-asset cases become loss leaders for the 5 percent of the cases where there are assets and where they may actually receive some reasonable compensation.

I understand my time is up, Mr. Chairman.

I would note that we believe the proposed bill would add an enormous workload. We would like to work with your committee to improve the system which has been proposed. We think that there are a number of things which could be done to make it work more effectively, and that is our main concern, to provide for an effective system. Thank you.

Mr. **GEKAS.** We thank you.

[The prepared statement of Mr. Waldschmidt follows:]

PREPARED STATEMENT OF ROBERT WALDSCHMIDT, ESQUIRE, CHAPTER 7 TRUSTEE, NASHVILLE, TN, ON BEHALF OF THE NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES

The National Association of Bankruptcy Trustees (NABT) represents the interests of over 1300 private trustees who administer cases filed under Chapter 7 of the Bankruptcy Code. By statute, a trustee is appointed in every Chapter 7 case, and they are responsible for administering the case. Over one million bankruptcy proceedings were administered by Chapter 7 trustees last year.

Page 431 PREV PAGE TOP OF DOC

The trustee's responsibilities include the reviewing of the petition and schedules, presiding over the meeting of creditors, examining the debtor, investigating assets, liquidating property, contesting the debtor's discharge (where appropriate), pursuing avoidance actions, and any other matter which facilitates the purposes of Chapter 7, as the law mandates.

In 95 percent of all Chapter 7 cases, there are no assets to administer, and the trustee performs all these investigatory functions for a flat $60 fee. In asset cases, trustees are entitled to a statutory fee established under §326 of the bankruptcy code, based on a percentage of the value of assets administered. In recent years, trustees have distributed over one billion dollars annually to creditors. It is the Chapter 7 trustee who becomes the chief facilitator and the driving force that allows Chapter 7 cases to be administered.

Trustees are not employees of the court, nor are they employees of any other governmental agency. The use of private trustees allows the system to be administered by individuals who can exercise their independent business judgment. The structure of the code encourages trustees to investigate the debtor's financial affairs and to administer assets for the benefit of creditors. The independence of Chapter 7 trustees and the incentives provided within the code to motivate trustees are the cornerstones to the effective operation of Chapter 7 cases.

NABT has already drafted a "response" to the Conference Report, outlining fourteen areas for comments and concerns as the bill would affect Chapter 7 Trustees. That response is still relevant in H.R. 833 and is attached to this submission as Exhibit 1.

The goals of NABT have been focused on the effective application of reform measures. Thus, our goals may be summarized as follows:

Page 432 PREV PAGE TOP OF DOC

1. The rules should be clear, such that trustees can administer Chapter 7 estates without ambiguity.

2. The reform legislation should not place an unfair or impossible burden on trustees.

3. The compensation for trustees should be adequate, particularly if new duties are imposed.

4. Trustees should not be exposed to personal liability or attack as a result of their good faith attempt to administer cases.

However, the most debated issue in the bill is the "needs-based" approach to bankruptcy reform, which is contained in section 102. The comments of NABT at this hearing will be focused on the mechanics of such a system in day-to-day practice.

First, trustees agree that any approach to "needs-based" bankruptcy should revolve around a modification to §707(b) of Title 11. H.R. 833 starts with this concept, and then attempts to create objective standards for determining abuse. These "tests" have been a major source of controversy.

Regardless of the intentions of any bill, the methods for implementation of any reforms are a serious concern to Chapter 7 trustees. Any amendments must provide for a vehicle through which the purposes of the bill can be satisfied. Otherwise, the statute will become dysfunctional, which would defeat one of the primary functions of this bill—to improve the administration of bankruptcy cases.

Page 433 PREV PAGE TOP OF DOC

The mechanism for enforcement of this new "needs-based" bankruptcy system is the Chapter 7 panel trustee. The bill essentially "deputizes" trustees to ensure that debtors file under the appropriate chapter. However, the implementation of these new duties by trustees creates a new layer of issues which could prevent the changes from becoming effective and functional.

Under the bill, trustees must (1) review the debtor's income and expenses prior to five days before the §341 hearing, (2) file a "certification" that the debtor is qualified to be a Chapter 7 debtor at least five days before the §341 hearing, and (3) file motions to dismiss under §707(b) where the debtor's disposable income would yield a $5,000 payment to a Chapter 13 trustee over a five-year plan.

This is a great deal of work for trustees who only receive $60 in the typical Chapter 7 case. In addition, the plight of the trustee is multiplied when, even if he is successful, he cannot count on any compensation. The bill only allows fees in cases where the debtor's counsel has acted improperly, which is not an effective way to mitigate the time and efforts of the Chapter 7 trustee.

Trustees are not employees of the government. They do not receive salaries but are dependent upon the results achieved in their cases in order to earn any meaningful compensation. Most trustees hire staff to help them with their caseload, but these assistants and paralegals must be paid directly by the trustee from fees generated in the cases. Therefore, multiplying the duties and functions of trustees will require additional staff and deplete more, if not all, of the fees generated by trustees.

Page 434 PREV PAGE TOP OF DOC

Furthermore, since they do not work under the umbrella of the government, they currently do not have any immunity from lawsuits by disgruntled debtors or creditors. If trustees are compelled to file motions to dismiss under §707(b), they face a real threat of being sued. First, if the trustee (due to the sheer volume of cases) misreads the income level of a debtor and certifies that the debtor may proceed under Chapter 7 (when in reality, they should convert to Chapter 13), then the trustee can expect that creditors will blame the trustee if a discharge is entered in the case, and the trustee will have no protection from these actions. Next, if the trustee files a §707(b) action and does not prevail, debtors may accuse the trustee of harassment and force the trustee to defend a frivolous suit. In either case, the trustee under the current proposal will have to perform these new duties under a real cloud of increased exposure to suit.

Furthermore, the "test" established under the proposed §707(b) is not easy to apply, and if trustees have to make subjective estimates, the problem of enforcement increases. The use of IRS guidelines does not cover many of the factors and expenses which need to be considered in order to establish a debtor's disposable income. Thus, trustees will have to make substantive judgments concerning a debtor's lifestyle and expenses, in order to comply with their new duties. This quasi-judge-like function is not appropriate for trustees in the bankruptcy system.

Private trustees are motivated to administer cases because they are rewarded when they obtain results through the administration of assets. The benefits to trustees are contingent upon the trustee's performance. Under the proposed bill, qualified trustees may elect to leave the panel. The risk of liability may become too great for practitioners, and the additional monetary burden may make trustee practice too costly. Furthermore, there is no motivation for trustees to be aggressive in pursuing §707(b) motions, since their compensation would not be altered regardless of the result. Thus, although trustees who remain on the panel would satisfy their statutory duties, the incentive for actively prosecuting §707(b) motions is lacking.

Page 435 PREV PAGE TOP OF DOC

If "needs-based" reform is going to be effective, the enforcement provisions need to be reconsidered. If the trustee's role becomes optional, and if the certification process is removed, or included as a form on the debtor's schedules, the risks to trustees would be minimized. However, if the panel trustee is supposed to become the driving force for the enforcement of these new provisions, NABT would suggest certain noncontroversial amendments:

1. The liability of trustees should be redefined. Under current law "a trustee in a case under this title has capacity to sue and be sued." There is no standard nor does the trustee have any immunity. Many courts have held that there are limitations on the trustee's exposure, but the decisions are inconsistent. Now, with a dramatic increase in the trustee's potential liability, there is an appropriate opportunity to clarify the trustee's capacity to be sued and to protect the trustee for acts taken in furtherance of the trustee's duties, or pursuant to court order. NABT would suggest amendments to §322 and §323 which are consistent with decisions from several courts of appeal. The inclusion of this language would eliminate one of the major impediments in section 102 of the bill.

2. Trustees need to be compensated for their efforts. The additional duties currently suggested by section 102 will greatly increase the time and expense incurred by the trustee in administering the typical Chapter 7 case. Since trustees are limited to a $60 fee in no-asset cases (and since 95 percent of all Chapter 7 cases are no-asset cases), the extra work will jeopardize the financial feasibility of remaining on the panel. The costs for additional staff, or the time diverted from other fee-producing work, render Chapter 7 trustee practice much less attractive. In cases where actions are commenced under §707(b), trustees should be awarded a reasonable fee if the case is converted to Chapter 13, and this fee should not be subject to the cap contained under §326 (this cap currently prohibits the award of a fee in a no-asset case). Then, since every case will require investigation and certification (even where no motions are filed), the trustee's fee in the basic no-asset case should be reconsidered. An increase in the no-asset fee would defray many of

the costs of the increased duties and responsibilities.

Page 436 PREV PAGE TOP OF DOC

3. The definition of "disposable income" needs further clarification. If trustees are compelled to review the income and expenses of debtors, then the "test" needs to be clear such that the trustee does not have to pass judgment on the reasonableness of the certain expenses. The lack of such clarity may cause trustees to file §707(b) motions where they should not be pursued or to certify a debtor as qualified when certain expenses may be exaggerated. Trustees do not have the judicial authority to make such subjective determinations concerning possible abuse.

Furthermore, if trustees are required to certify the eligibility of debtors, the report should not have to be filed until five to seven days *after* the §341 hearing. Many trustees learn a great deal about the debtor at these hearings, and the examination allows the trustee to clarify any ambiguities within the debtor's schedules. A report filed after the §341 hearing would be more accurate than the trustee's blind "guess" (based solely on the debtor's schedules).

H.R. 833 constitutes a major modification of the balance of rights between debtors and creditors. The bill seeks to establish a new standard for obtaining relief under the bankruptcy code. However, in the midst of the debate over the new approach to bankruptcy, it is important to ensure that the methods for implementing these new measures will accomplish the goals that Congress intends. The current draft contains several "gaps" in this regard, but this bill can be made efficient if the considerations mentioned herein are adopted.

Thank you for inviting me to participate in these hearings, and NABT welcomes the opportunity to contribute further in this legislative process.

Page 437 PREV PAGE TOP OF DOC

EXHIBIT 1

NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES POSITION ON AMENDMENTS TO THE BANKRUPTCY CODE

The proposed bankruptcy legislation (including HR 3150, S. 1301, and the Conference Report) involved dramatic proposed changes in the Bankruptcy Code, which attempted to deal with numerous competing public policies. NABT, on behalf of Chapter 7 trustees, anticipates the introduction of new legislation in 1999, and will continue to provide constructive comments on the various ideas which have been, or may be, proposed.

However, Chapter 7 trustees will be directly involved in the administration of any new policies and hence are extremely concerned about changes which will impair their ability to function within the new system. Trustees approach bankruptcy reform with five primary requirements for an effective system:

1. The Code must be drafted in a manner which is practicable, sensitive to all parties in interest, fair and reasonable, and capable of uncomplicated, inexpensive implementation.

2. The rules must be clear such that the trustees can administer Chapter 7 estates without ambiguity.

3. The reform legislation should not place a unfair or impossible burden on trustees.

4. Compensation for trustees should be adequate, particularly if new duties are imposed on trustees.

Page 438 PREV PAGE TOP OF DOC

5. Trustees should not be subjected to any added exposure or personal liability as a result of trying to administer cases under an amended system.

These concepts are essential to maintaining a quality trustee panel with the resources and protection to adequately administer the bankruptcy statutes enacted by Congress.

The Conference Report (H.R. 3150) and the two separate bills (S. 1301, and the original H.R. 3150) include numerous sections and changes which impede the administration of cases, discourage efforts of Chapter 7 trustees, or, in some cases, actually defeat the initial purpose of the proposed amendment. The following outlines these areas, with suggestions for improvement:

1. Needs-based Bankruptcy (Conf. Rep. Sec. 101)

A major revision of §707(b) is the appropriate mechanism to prevent debtors from obtaining relief which would constitute an abuse under Chapter 7. However, the strict guidelines, and lack of discretion on the part of the trustees and the Court, render this provision unworkable.

Trustees are particularly concerned about the requirement that Chapter 7 trustees file a report of eligibility in every case, and then that trustees pursue motions to dismiss in every case where the objective criteria are not satisfied. Chapter 7 trustees report that for every ten cases where debtors have the "apparent ability" to propose a Chapter 13 plan, closer review and scrutiny of the debtors financial affairs will reveal that only one of those ten could actually confirm or complete any Chapter 13 proceeding. Therefore, trustees would be required to file an additional report for every no-asset case, and would have to pursue every potential §707(b) violation, even though 90 percent of those would be futile. This additional work is being expected, even though trustees will only receive $60 for each no-asset case.

Page 439 PREV PAGE TOP OF DOC

NABT would support a more flexible approach to §707(b), which would allow motions to dismiss in situations where debtors should not receive a fresh start. If objective guidelines are imposed, they should be sufficiently flexible to allow the judges and the trustees some discretion in determining whether these debtors have improperly filed cases under Chapter 7. Furthermore, most trustees do not want the increased tension, which would be created if trustees were expected to recover costs and expenses from debtors' attorneys. The administration of bankruptcy requires the cooperation between trustees and debtors' counsel, and most trustees would be reluctant to impair their relationships with attorneys, as a result of a successful motion to dismiss.

NABT has previously suggested that costs and fees be specifically allowed as an administrative expense in the debtor's subsequent Chapter 13 (regardless of whether it is converted from Chapter 7 or filed separately at a later time) and that the fees and expenses be a nondischargeable debt in any subsequently filed bankruptcy proceeding. In addition, trustees (particularly those that are not attorneys) need the right to receive compensation (in excess of $60) in cases where they succeed in transferring a case from Chapter 7 to Chapter 13. Currently, the limitations in §326 prohibit trustees from receiving a fee, unless money is received and disbursed into their bank account. Thus, a provision which allows for a reasonable trustees fee, notwithstanding the limitations of §326, would be appropriate for any converted case.

2. Domestic Support Priorities (Conf. Rep. Sec. 142)

Trustees are encouraged to administer assets and insure a fair and equal distribution to creditors. The priority scheme in §507 has given preferred treatment to certain types of claims, either through consideration of public policy or through the efforts of special interest groups. Although trustees generally believe that the number of priority classes should be reduced, rather than expanded to include additional classes, the basic administration of Chapter 7 estates is not hampered by any change to §507 as long as the administrative expenses involved in the bankruptcy proceeding are satisfied. Section 507(a)(1) has always been the first priority, and its position is necessary in order to prevent bankruptcy estates from becoming "administratively insolvent."

Page 440 PREV PAGE TOP OF DOC

The modification for the priority for domestic support obligations would not impose any adverse consequences on trustees if the position of these claims was elevated to the second level. This would allow cases to be administered, and ex-spouses could receive the first distributions from the bankruptcy estate after the assets were administered.

However, the Conference Report elevated these claims to first priority, ahead of administrative claims and expenses. This would not only be detrimental to bankruptcy estates, but would also be devastating to the domestic support claimants. If the debtor has made preferential transfers or fraudulent conveyances prior to bankruptcy (in order to avoid paying an ex-spouse), the trustee may be the only party who could recover those payments under §547 and/or §548. However, if the trustee cannot hire an attorney, because those attorney fees would be subordinated to the claim of the ex-spouse, the trustee would never be able to pursue these actions. Likewise, if assets needed to be administered which required the use of a real estate agent, auctioneer, or other professional, the trustee would be prevented (or discouraged) from hiring those professionals, because their payment would not be guaranteed. Therefore, domestic support claims can be elevated to the second priority in §507, but the amendments should not modify a trustee's ability to satisfy administrative claims as the first priority in §507(a)(1).

3. Consumer Credit Counseling (Conf. Rep. Sec. 302)

Debtors should be encouraged to investigate any realistic alternatives to bankruptcy, and Consumer Credit Counseling Services provide many debtors with repayment plans which accomplish that goal. Unfortunately, only debtors with "disposable income" can benefit from these services. Since 85–90 percent of all Chapter 7 debtors do not have any disposable income, the mandatory channeling of these debtors through a counseling service is meaningless. (Education of debtors is a worthy goal, and debtors should be given the opportunity to improve their knowledge of budgetary principles, so that they can use credit wisely in the future. However, most of these debtors are already beyond rehabilitation, and need a fresh start.)

Page 441 PREV PAGE TOP OF DOC

One major problem with the procedural structure of this provision is the incorporation of this precondition as an eligibility issue in §109. The uncertainty of knowing whether a debtor is eligible or not creates an unworkable environment in a Chapter 7 proceeding.

Chapter 7 trustees are often required to take immediate possession of assets, obtain insurance, hire professionals, and sell assets during the first few weeks of the case. If a debtor's "eligibility" status is uncertain, trustees are placed in the impossible position of acting with indefinite authority. Either (1) the trustee will not take any action until the eligibility status has been determined which could result in assets being wasted, or their value decreased, or (2) the trustee could presume that the debtor was eligible, in which case (if the case is later dismissed) the trustee could be sued for acting without authority, and could also be denied reimbursement of expenses incurred at the beginning of the case.

Eligibility issues are functional in Chapter 13 proceedings, since the trustee only receives cash from the debtors, which can always be returned in the event a case is dismissed for lack of eligibility. However, Chapter 7 trustees are required to take actions which are not "reversible" and which could cause irreparable harm to debtors or creditors if the case is subsequently dismissed for lack of eligibility. Therefore, if Consumer Credit Counseling is incorporated into the bankruptcy reform process, it should not involve an eligibility issue in §109. (Including the failure to complete this counseling as a grounds for dismissal under Section 707, or including this failure as a grounds for objection to discharge are alternative devices which could be used in place of §109.)

Page 442 PREV PAGE TOP OF DOC

4. Exemption Laws (Conf. Rep. Sec. 126)

Trustees are often frustrated by exemption laws which allow debtors to protect an excessive amount of property. NABT would support the change which would require debtors to be domiciled in a state for two years before taking advantage the new exemption statutes. However, the Conference Report did not cover the gap during which the debtor has become a resident in a new state. If a debtor moves, can they still take advantage of the exemption statutes from the previous state, or are they denied any exemptions during the two years after changing their residence? This issue needs clarification.

5. Property of the Estate (Conf. Rep. Sec. 121)

Under the proposed revision, if a debtor does not carry out his/her intention with respect to secured property, the property ceases to be property of the estate under §541. Unfortunately, this does not consider the role of the trustee, who is required to review the security documents of secured creditors and determine whether there is any equity in the property.

If the debtor does not file this statement of intention, and the property is removed from the bankruptcy estate, this effectively strips the trustee of any authority to administer the property which might be a valuable asset to the estate. Debtors could use this as a device to protect a secured creditor which has not properly perfected their security interest in order to prevent the trustee from liquidating the asset.

The failure to complete the appropriate intention could be included within the grounds for dismissal under §707, or as grounds for denial of the discharge under §727. However, the automatic "evaporation" of property from the trustee's control is not the proper mechanism to force debtors to satisfy their duties.

Page 443 PREV PAGE TOP OF DOC

6. Automatic Dismissal (Conf. Rep. Sec. 604)

The bill provides for an automatic dismissal by the clerk, if the debtor does not file necessary information connected with the petition. In theory, this is appropriate, but it does not function in numerous cases.

If the trustee is administering assets in the case, or if creditors would prefer to keep the debtor in bankruptcy (within the jurisdiction of the court), dismissal may not be preferable.

NABT would suggest that the failure to file the necessary documents should constitute grounds for dismissal under §707, or become grounds for objections to discharge under §727.

The "automatic" dismissal could actually benefit debtors who, once they become involved in the bankruptcy proceeding, decide that they do not want to be subject to the jurisdiction of the court. They would, under this provision, be able to defeat creditors and the trustee, if the case was not proceeding according to their original design.

7. Preferences (Conf. Rep. Sec. 211 & 212)

In nonconsumer cases, trustees would be prevented from pursuing preferences under $5,000 and would be required to travel to the defendant's venue to pursue actions under $10,000. These are provisions which are reasonable in the extremely large business cases where $5,000 is not meaningful to creditors.

Page 444 PREV PAGE TOP OF DOC

However, Chapter 7 trustees are routinely involved in small business cases, often with debts which do not exceed $50,000. A $5,000 recovery by the trustee is extremely meaningful to these claimants and results in an effective administration of the bankruptcy estate. The preference statute also encourages trade creditors to negotiate with the debtor prior to bankruptcy. (If creditors did not have to worry about avoidance of preferences, they would "race" to the debtor's bank account, thereby forcing a bankruptcy or ruining any rehabilitative alternatives.)

In addition, if a trustee is required to travel across the country to pursue a $9,000 preference, it will result either in the trustee fees and expenses consuming most of the recovery or in the trustee electing not to pursue a valid cause of action for the benefit of the estate. Creditors/claimants are already required to pursue their remedies (file motions for relief from stay, file claims, contest dischargeability) within the jurisdiction where the case is pending. It does not make sense to bifurcate a bankruptcy proceeding into several jurisdictions, particularly at the expense of the trustee.

8. Trustee Due Process (Conf. Rep. Sec. 1130)

NABT has supported efforts to provide panel trustees with a meaningful "review" in situations where a trustee is removed or suspended from the Chapter 7 panel by the U.S. Trustee. The provisions contained in the Conference Report are consistent with that goal, and, although the trustees believe that bankruptcy judges are in a better position to resolve these issues and that a de novo review would be preferable, the provisions contained in the Conference Report did provide a mechanism (where none existed before) by which trustees can receive a judicial review of any actions taken by the U.S. Trustee which affect the ability of the panel trustee to continue receiving cases.

Page 445 PREV PAGE TOP OF DOC

9. Trustee Compensation (Conf. Rep. Sec. 208)

NABT supports this clarification of the criteria for allowing a trustee's fee. In most jurisdictions, the percentage calculation contained in §326 is allowed as the trustee's fee, but some jurisdictions take different approaches.

The drafters of the Bankruptcy Code intended for trustees to be rewarded for results in a case, to encourage Chapter 7 trustees to investigate the affairs of the debtor and to administer assets. The recognition of these fees as a "commission" is consistent with prior legislative history and should be made retroactive for all pending cases so that trustees will realize the effect of the legislation upon its enactment. (A retroactive provision would eliminate the possibility that dual standards could be applied for pre- and post-enactment cases.)

10. Tax Provisions (Conf. Rep. Sec. 813, 815)

NABT supports these tax provisions. Prior amendments made it possible that a taxing authority could wait or delay in filing a claim until the trustee actually placed the disbursement checks into the mail (thereby creating uncertainty). The new proposal would require late filed priority tax claims to be filed prior to the date of the approval of the final report.

In addition, the modification to §505 which would discharge the bankruptcy estate from further tax liability (in addition to the trustee) is appropriate and clarifies the original intent of this section.

Page 446 PREV PAGE TOP OF DOC

11. Effective Date (Conf. Rep. Sec. 1201)

NABT supports the delay in effectiveness of any reform legislation for at least 180 days. The changes which are being discussed are substantial, and all professionals in the bankruptcy system, including trustees, will need sufficient time to become educated and to develop procedures for effectively administering the new provisions.

12. Deemed-filed Rule (Former HR 3150)

Fortunately, the deemed-filed rule was not included in the Conference Report, but it was included in the original House bill. NABT has continually expressed its concern over such a rule, which would attempt to infer that every creditor listed on the debtors' schedules has a valid allowed claim filed with the court. In essence, the debtors would determine which claims are allowed, and in what amount, by including those creditors on their schedules.

Administratively, this concept would become a disaster. Trustees must rely upon claims asserted directly by creditors, in order to perform their duties of recommending allowance and disallowance of claims. Without backup documentation, trustees might be required to object to every claim of every creditor listed on the schedules, which would result in (1) all creditors having to hire counsel to defend their claims in the bankruptcy court, (2) a burden on the courts which would have to address these claims issues, and (3) the incurring of significant administrative expenses by trustees who would have to hire counsel to pursue these objections.

The current system of requiring creditors to file claims is sufficient and extremely economical. NABT hopes that the deemed-filed rule is not included in any final bill.

Page 447 PREV PAGE TOP OF DOC

In addition to those provisions discussed above, the Conference Report failed to address two other important issues which are very important to prevent abuse, and to allow trustees to effectively administer bankruptcy estates.

13. Conversion from Chapter 13 to Chapter 7

One common form of abuse in the current system occurs when debtors, who have been protected within a Chapter 13 plan, convert to Chapter 7, discharge their post-petition, pre-conversion debt, but retain their post-petition, pre-conversion assets. Debtors who receive inheritances, personal injury recoveries, raises, bonuses, gifts, appreciation in property, or some other "windfall" can keep that property from the Chapter 7 trustee under §348(a), even though new liabilities (often incurred in violation of their Chapter 13 plan) can be included and discharged in their converted case under §348(d). Property of the estate should be expanded to include property which the debtor acquires post-petition, but prior to conversion. In the alternative, the debtor should not be allowed to discharge any post-petition debt, unless they consent to the administration and liquidation of their post-petition, non-exempt assets. Otherwise, the debtors can use Chapter 13 as a device to acquire assets which will be immune from administration in their subsequent Chapter 7 case.

14. Trustee Liability

Trustees are exposed to many forms of attack from debtors and creditors. Under §323, a trustee can sue and be sued. Unfortunately, the bankruptcy code does not provide trustees with explicit protection against frivolous actions where the trustee has acted within the scope of the trustee's rights or duties, or in reliance upon a valid court order. Consequently, trustees are faced with a crazy quilt of case law throughout the country providing many different standards of care governing personal liability of trustees.

Page 448 PREV PAGE TOP OF DOC

The National Bankruptcy Review Commission recommended an amendment to the Code which would clarify the potential personal liability of trustees. NABT would encourage a similar amendment (with some modification) to §323, which would protect trustees from personal liability if they are acting under court orders, or acting pursuant to their rights or duties as defined under the Code. Trustees should only be exposed to personal liability if they intentionally take actions with knowledge that those actions are outside the scope of their authority, or violate the provisions of a valid court order.

Section 322, governing the trustee's bond, must also be amended so that its provisions are consistent with the proposed changes to §323. Otherwise, any case filed against a trustee which could be dismissed under §323 could simply also be filed against the trustee's bond on the basis that "faithful performance" required under §322 equates to mere negligence. Once the surety pays on the bond, the trustee would be required to repay the surety on a contractual basis.

Finally, the entire bankruptcy court system and creditors of all estates would be well served if frivolous litigation could be ended before it starts. The Code should be amended to adopt the presently existing, but little known, Barton doctrine, which requires that cases filed against liquidating trustees be filed only after seeking the permission of the bankruptcy court.

CONCLUSION

The areas outlined above may not include every element of the Conference Report which could affect trustees, but does address the major provisions which have been identified by Chapter 7 trustees. NABT welcomes the opportunity to focus on any proposed legislation and to provide further input on any of the issues before Congress.

Page 449 PREV PAGE TOP OF DOC

Mr. **GEKAS.** And we turn to Mr. Hildebrand.

STATEMENT OF HENRY E. HILDEBRAND, III, ESQUIRE, CHAPTER 13 TRUSTEE, NASHVILLE, TN, ON BEHALF OF THE NATIONAL ASSOCIATION OF CHAPTER 13 TRUSTEES

Mr. **HILDEBRAND.** Thank you, Mr. Chairman, Mr. Watt.

I am Hank Hildebrand. I am the Chapter 13 Trustee from the Middle District of Tennessee. I have been Chapter 13 Trustee for about 17 years, and during that period of time I have administered about 60,000 to 65,000 cases. I now handle a case load of about 14,000 cases; and last year I disbursed to creditors approximately $80 million.

In the cases of debtors that accomplish their chapter 13 plans in Nashville, those where debtors who did what they were supposed to do, 52 percent of those debtors paid 100 percent of their debt back through chapter 13: They paid everything back.

The panel that sits before you today are the professionals who are going to take the words that you draft and implement them and apply them to the families and businesses that come into the system. Now, I want to emphasize that I appear today for myself, I appear today for the National Association of Chapter 13 Trustees; and I appear for the bankruptcy professionals that are from my district.

The chapter 13 trustees are committed to helping you, Mr. Chairman, Mr. Watt, in creating the drafting of language that accomplishes the goals that you set out as the policies of the United States. We are committed to improve the Bankruptcy Code to make changes that will remove abuses that you have identified. We support modifications that will encourage more families to repay the debts to the best of their abilities, either without the need of bankruptcy or, if they have to, through a bankruptcy process.

Page 450 PREV PAGE TOP OF DOC

The trustees support providing additional information about debts, the cost of the debts, what their repayment options are and other information that they can get when they borrow money. The trustees support the increased educational opportunities that are present in your bill.

We support the attempts to let families emerge from bankruptcy better capable of paying back debts in the future. We support all of those elements that will improve notice to affected parties, will expedite prompt hearings, and will give everyone an opportunity for a more prompt distribution of available funds. We support all of that.

The trustees want the changes that you articulate in this bill to work. We want to make certain that the goals that you set out, the policies you set out can be accomplished by the groups that are represented on this panel today.

We want to encourage them to pay their debts, but we want to caution you that the large bulk of chapter 13 debtors right now are there, not because they must be or are compelled by the law, but because they want to be. They are incented into a system which will allow them to pay their debts back as best they can.

We are suggesting four modifications to your bill that could preserve the incentives that debtors have to voluntarily participate in the chapter 13 program.

First, the anti-cram-down provisions you have would pay one class of creditors to the detriment of other creditors, and restrict the ability of these voluntary debtors in chapter 13 to restructure debt payments in a feasible way.

Page 451 PREV PAGE TOP OF DOC

I note that H.R. 3150 did not originally contain this provision last year. It was put in by the conference committee. And it seriously undermines the voluntary nature of the chapter 13 that exists today.

Second, we should shift determination of those debts that should not be discharged in chapter 13 away from creating an exception to discharge and put them where they belong: as elements that a bankruptcy judge must, and I underscore that, *must* consider in determining whether a debtor's repayment plan in chapter 13 is an appropriate repayment plan, before it is approved. Remember only after a judge approves a chapter 13 plan is it effective.

Third, we should shift the burden of the responsibility from debtors making what is being called "adequate protection payments," these payments that they must make before a plan is approved, and put that responsibility on the trustees. Let the chapter 13 trustees make these disbursements of adequate protection, if necessary, when a creditor files its claim so trustees can examine whether the debt is a valid debt.

And, finally, put the consumer credit counseling provisions, which would create a barrier to entry into the system, where they belong in chapter 7 only. I submit to you that if prepetition credit counseling is necessary, then it should be for the chapter 7 debtors who do not seek to repay debts. Because in chapter 13, under H.R. 833, you have imposed mandatory education requirements, you have a required repayment plan, you have necessitated the creation of a budget, and debts would actually be paid.

I submit to you that that is the goal of your consumer credit counseling provision. If what we want to do is improve the system, we should recognize that chapter 13 accomplishes those goals in this bill and that, therefore, chapter 7 debtors may be the ones we need to target for the prepetition consumer credit counseling.

Page 452 PREV PAGE TOP OF DOC

I want to say, Mr. Chairman, that all of us at this table, all of us, want to work with you to put together the best possible bill that can be put together; and we are ready to help you on that, Mr. Chairman. Thank you.

Mr. **GEKAS.** We thank you.

[The prepared statement of Mr. Hildebrand follows:]

PREPARED STATEMENT OF HENRY E. HILDEBRAND, III, ESQUIRE, CHAPTER 13 TRUSTEE, NASHVILLE, TN, ON BEHALF OF THE NATIONAL ASSOCIATION OF CHAPTER 13 TRUSTEES

My name is Henry E. Hildebrand, III and I currently serve as a standing trustee for Chapter 12 and Chapter 13 cases filed in the Middle District of Tennessee. I have also served as a Chapter 11 trustee. I currently serve on the Board of Directors of the National Association of Chapter 13 Trustees and the Trustee's Education Network. I currently administer nearly 14,000 active Chapter 13 cases and I disburse approximately $80 million per year to creditors.

On behalf of the hundreds of members of the National Association of Chapter 13 Trustees, I want to thank you for the opportunity to appear before this Subcommittee to comment on consumer bankruptcy reform and to assist you in your focus on examining the impact H.R. 833 would have upon the consumer bankruptcy system.

The National Association of Chapter 13 Trustees is a non-profit organization devoted to providing education and information related to the consumer bankruptcy process focusing particularly on Chapter 13 bankruptcy. Our members include trustees; attorneys who represent debtors, creditors and debt collection managers; academics; and other persons interested in the consumer bankruptcy system. Our membership is diverse geographically, politically, and economically and the individual interests of our members relating to bankruptcy reform cover a wide spectrum. The Chapter 13 trustees who are members of the NACTT do not represent interests that could be called "pro-debtor" or "pro-creditor." The trustees generally have no economic interest in whether there are more or less bankruptcy petitions filed. This being said, there is one unifying theme voiced by all of the trustee members of the NACTT: whatever results from the overhaul of the consumer bankruptcy system undertaken by Congress, the law must be functional, must be capable of easy application, and must actually accomplish the stated goals of Congress. The Chapter 13 Trustees are deeply concerned over the impact of H.R. 833, not so much for its underlying policies, but the startling realization that the language currently before the House *will not accomplish the goals of the drafters.*

Page 453 PREV PAGE TOP OF DOC

I wish to make this point extremely clear. In its current form, H.R. 833 will discourage the Chapter 13 option for debtors seeking bankruptcy relief, will impose significant hardships and costs on debtors and creditors who are involved in the bankruptcy process, will impose significant unfunded costs on the system, and will result in the inequitable and reduced distribution of any dividend to creditors.

The NACTT has undertaken an analysis of the various consumer related provisions of H.R. 833 and we attach our comments to these sections as Appendix A to this testimony.

For purposes of this testimony today, however, we would like to sound the clarion bell of warning that the current draft of the bill will decimate many Chapter 13 programs across the country. The tragic thing about this fact is that the policies sought to be addressed by Congress can be achieved without such a destructive impact. Many Chapter 13 trustees are strongly supportive of many of these policies.

The NACTT encourages this Committee to restore the protections and benefits of Chapter 13 in H.R. 833. We believe, at a minimum, the following changes must be made to preserve a viable Chapter 13 option:

I Prohibition upon Valuations in Chapter 13 Plans

Current Law: Under existing law, a claim is a secured claim only to the extent of the value of the collateral. This is a recognition that the secured creditor has an interest in the property that secures the loan and a claim against the debtor to the same manner as a general unsecured lender. If the collateral is insufficient to satisfy the creditor's debt, the creditor can pursue the debtor for the deficiency. In Chapter 13 a debtor proposing to retain property that is subject to a lien must either surrender the property (which would give the creditor the collateral and an unsecured claim for any deficiency), or pay to the creditor the replacement value of the collateral with interest sufficient to provide the creditor the present value of the property. There is an exception to such treatment for debts secured only by a debtor's principal residence.

Page 454 PREV PAGE TOP OF DOC

H.R. 833: Section 123 of the bill would require that to confirm a Chapter 13 plan (also applicable to a Chapter 12 farmer's case and a Chapter 11 individual's case) a claim that is secured by a purchase money security interest in the debtor's property must be treated as if the property had a value equal to the debt, if the property were purchased within 5 years of the filing.

Apparent Justification for the Provision: Debtors should not be permitted to purchase items on credit, effectively planning a bankruptcy to the detriment of well intended creditors. Debtors who incur a debt on the eve of filing do so seeking to retain property purchased by such credit while limiting their personal exposure on the debt. The provision could prevent "eve of bankruptcy" buying sprees.

Anticipated Effect of the Provision: The bill would force reorganization plans to divert significant portions of a debtor's available income, now generally available for unsecured creditors of all types, to fund the under-secured claims of PMSI creditors. Since a debtor in Chapter 13 must dedicate all disposable income to fund a plan, the only possible outcome is to divert funds from one type of unsecured creditor (medical bills, credit cards) to another (PMSI deficiencies). Many debtors who would not be compelled to file Chapter 13 under any sort of means testing in an effort to reduce (not eliminate) their debt load currently elect Chapter 13 If enacted this provision would provide such "voluntary" debtors a much better result in a Chapter 7 (by reaffirming on the debt agreeing to pay it in full). The result would be a significant decrease in *voluntary* Chapter 13 plans which under current law pay a substantial portion of debts back.

Page 455 PREV PAGE TOP OF DOC

Alternative: Since very few debtors have the ability or the foresight to plan a bankruptcy, the effort to divert funds from unsecured creditors to secured creditors to compensate for this abuse is misdirected. The Bankruptcy Code now uses the period of 90 days as a presumption of preference (Section 547), and a presumption of a buying spree on a credit card (Section 523(a)(2)(C)), it would seem to be consistent to limit such diversion to property that is acquired within the three months prior to filing.

II Adequate protection Payments in Chapter 13 Cases

Current Law: There is no specific provision for preconfirmation distribution of funds to creditors in Chapter 13 cases. Courts in some districts do provide for such preconfirmation payments. The Code requires debtors to dedicate all of their disposable income to fund a Chapter 13 plan. Such payments must commence within 30 days of the filing of the Chapter 13 plan. If a secured creditor is harmed as a result of the delay, the creditor may request the court impose an obligation on the trustee of providing preconfirmation payments to the creditor as a form of adequate protection. Because some courts refuse to confirm a Chapter 13 plan (even if the plan is uncontested) for a significant period of time, often waiting until after the bar date for filing claims (which can be 180 days after the filing of the petition), and because there is no provision for an under-secured creditor to accrue interest on the obligation until the plan is confirmed, creditors are now injured economically by the very fact of filing.

H.R. 833: The bill would compel the court to hold early confirmation hearings (Section 605 of the bill) [This same provision (Section 605(b)) permits a debtor to delay the filing of a Chapter 13 plan for a period of 90 days from existing 15 days]. The bill would also compel a debtor to maintain contract payments to purchase money secured creditors *in addition* to their payment of *all disposable income* to a Chapter 13 trustee. [It is very confusing to determine the source of such payments since all disposable income is defined as all income not necessary to support a debtor or a debtor's dependents. Such adequate protection payments *must* be paid from the funds needed to support the debtor and the debtor's family.] The court might be able to modify these payments upon the request of a party in interest [although such is not clear] and the payments from the debtor would continue until the debtor either relinquished the property of the creditor began to actually receive payments under the plan.

Page 456 PREV PAGE TOP OF DOC

Justification for the Provisions: The principal complaint of secured creditors is delay in Chapter 13. The inherent delay in the commencement of a Chapter 13 repayment plan, conducting of a meeting of creditors, consideration and modification of the plan by parties in interest and consideration of confirmation of the plan all take time. During this period the under-secured creditor's interest is losing value. While a creditor could seek adequate protection, given the size of the claims involved, the costs of such action seem to outweigh the benefits on a case by case basis. System wide, however, such delay is substantial.

Effect of the Provision: The difficulty in dealing with a requirement that Chapter 13 debtors pay to a trustee all of their disposable income (all income not reasonably necessary to maintain or support a debtor or a dependant of a debtor) and *at the same time* pay additional funds to creditors is apparent. In most courts, trustees are the disbursing agents as to all claims (other than ongoing mortgage payments and child support). The provision appears to require a debtor to pay twice—once to the trustee under a proposed plan and once to the purchase money secured creditor under this provision.

The provision precludes a trustee from accurately making disbursements on a secured claim after confirmation of a plan since the debtor should have made some payments on a claim as to which there will be no accounting. Trustees will be forced to compel creditors holding such claims to make accountings prior to disbursements under a plan.

The provision is somewhat confusing in that it states that the court can modify the amount and timing of such "adequate protection" payments (in which case it is reasonable to expect a substantial amount of "first day" orders as in Chapter 11 cases) but then it states that the modification cannot alter the contract frequency of payments and cannot alter the contract amounts of such payments. It is not at all clear what modifications could be permitted.

Page 457 PREV PAGE TOP OF DOC

Clearly, the provision will result in diminished distributions in Chapter 13 plans to other secured creditors, resulting in delays in curing mortgage defaults (plans would need to be crafted to reduce payments on mortgages and nonpurchase money secured creditors in order to provide the debtor with sufficient funds to make the direct "adequate protection" payments) and reduced distributions to unsecured creditors .

Since trustees may only assess fees upon funds that the trustees actually distribute(see 28 U.S.C. Section 586(e)), the provision will preclude the collection of fees necessary to administer Chapter 13 cases. The most significant costs incurred by a trustee occur in setting up and shepherding a case to the confirmation hearing. To the extent the provision will diminish trustee distributions, the provisions seriously undercuts the ability of trustees to have resources to administer the cases entrusted to them.

Suggested Alternatives: To more effectively accomplish the goals of the provision without impairing the ability of trustees to administer cases, the following changes are suggested:

1. Modify Section 1325(a)(5)(B) by adding a new subsection (iii) which provides that if a plan proposes to satisfy an allowed secured claim (other than a claim secured only by real property) in installment payments, the payments should be equal monthly payments sufficient to provide adequate protection of the secured creditors' interest.

2. Amend Section 1321to require the debtor to file a plan within 15 days unless the court, for cause, extends such time.

Page 458 PREV PAGE TOP OF DOC

3. Require prompt confirmation hearings as contemplated in Section 605 of the bill but permit earlier confirmation than 20 days if there is no objection to confirmation raised at or prior to the meeting of creditors.

4. Amend Section 1326 to require the trustee to make preconfirmation distributions to purchase money secured creditors holding allowed secured claims in an amount equal to proposed plan distributions. Because plans would be filed quickly, trustees could make distributions quickly. A creditor could still seek a greater distribution than proposed by filing a request with the court, but since the plan must provide adequate protection (see #1 above) a purchase money creditor need do nothing to receive adequate protection.

5. Amend 28 U.S.C. Section 586(e) to permit the trustees to recover the percentage fees from funds received for disbursements, whether such disbursements are prior to or after confirmation.

6. Amend Section 1326(b)(1) to preclude confirmation of a plan which proposes to make administrative payments in a manner which impairs or delays a secured creditor from actually receiving the adequate protection payments provided in section 1325(a)(5)(B)(iii) [see #1 above]. This will preclude the frontloading of administrative costs in a plan which has caused delays to a creditor's distributions.

7. Amend 1326(a)(1) to require debtors to commence payments to a trustee no later than 30 days after filing of the case—not 30 days after filing of the plan.

III Destruction of the Superdischarge

Page 459 PREV PAGE TOP OF DOC

Current Law: A Chapter 7 discharge will not discharge all debts. There is excepted from discharge 18 different types of debts in 523 [several exceptions to discharge exist in other parts of the United States Code]. Section 1328(a) does not exclude nearly so many debts from discharge in a Chapter 13 case, excepting long term debts treated under 1322(b)(5) such as mortgages, support obligations, student loans, DUI personal injury obligations, and criminal restitutions or fines. The reason for this as articulated by the drafters of the 1978 Code, is that in exchange for a debtor voluntarily committing all disposable income to fund a plan for a period of three to five years, such a debtor should be able to obtain a true fresh start.

H.R. 833: The bill would except from discharge in a Chapter 13 plan any debt of a kind listed in 523(a)(1),(2),(4) and (6)(to the extend of personal injury or wrongful death) (See Sections 129 and 807 of the Bill).

Justification for the provisions: It seems unfair to permit debtors to escape from their obligations to pay debts that public policy holds should not be discharged in a Chapter 7. Some debtors may be filing for Chapter 13 relief only to avoid debts that are incurred through fraud, embezzlement or willful injury to others. Chapter 13 has been used by a few debtors to discharge tax obligations that would not be discharged in a Chapter 7 because the debtor did not file a tax return or the return that was filed was a fraudulent return.

Effect of the Provisions: While it is true that some debtors seek to avoid the dischargeability litigation that results in some Chapter 7 cases by filing under Chapter 13, it should not be assumed that such debtors have debts that *would* be excepted from discharge after a trial. Many such debtors file under Chapter 13 to avoid the cost and difficulty of litigation. Section 129 of the bill will require litigation in all cases which *might* involve nondischargeable debts and such actions must be commenced within 60 days of the meeting of creditors. This would be required even where a creditor is willing to accept a Chapter 13 plan as proposed.

Page 460 PREV PAGE TOP OF DOC

If a debtor is to face litigation in both a Chapter 13 case and a Chapter 7 case, it only makes sense for that debtor to *elect* a Chapter 7 case which would be quicker and would result in the discharge of claims that would receive some distribution in a Chapter 13. This would clearly result in fewer voluntary Chapter 13 cases being filed and an increase in Chapter 7 cases.

The provision would also make taxes nondischargeable in a Chapter 13 case. While current law prohibits confirmation of a Chapter 13 case which does not propose to pay priority taxes in full, the provision would also make nondischargeable the interest that accrues on taxes post petition. Because post petition interest is not a "claim", it could not be paid in a Chapter 13 plan. Thus a debtor would emerge from Chapter 13 still owing the post petition interest on taxes that accrued during the plan.

Alternatives: If courts were *compelled* to consider the dischargeability of debts in their consideration of confirmation of a Chapter 13 plan, the use of Chapter 13 to avoid paying debts would be limited. Section 1325(a)(3) should be amended so as to require a finding of a lack of good faith if the Chapter 13 plan does not propose to make a meaningful distribution to creditors who hold claims of a kind described in 523(a)(2), (4) and (6). Further, 1322(b)(1) should be amended to permit a Chapter 13 plan to pay those debts that are nondischargeable under Chapter 7 differently than other unsecured creditors. This would permit debtors to craft Chapter 13 plans that could make meaningful distributions to potentially nondischargeable debts.

Section 1322(a)(2) should be amended to require a Chapter 13 plan to pay in full any tax obligation with respect to a return, if required, was not filed, or with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat the tax. Such would accomplish the goal of closing the loophole that permits fraudulent or undisclosed taxes from being discharged, but would not force debtors to face the Hobson's choice of trying to repay taxes but emerging from bankruptcy still owing the interest that had accrued.

Page 461 PREV PAGE TOP OF DOC

IV—Prefiling Consumer Credit Counseling

Current Law: Nothing now requires a debtor to seek to work on a voluntary basis with their creditors prior to the filing of a bankruptcy. Some, but not many, debtors' counsel seek to work out debts with creditors prior to filing a petition.

H.R. 833: Section 302 would make it a condition to filing a bankruptcy that the debtor have received credit counseling within 90 days which counseling would include an individual or group "briefing" that outlined opportunities for additional counseling and an "initial budget analysis". The bill has an exception to this requirement only if there is a geographic barrier to obtaining such counseling or the counseling service could not be obtained within 5 days.

Justification for the provisions: There is insufficient effort by debtors to seek non-bankruptcy workouts prior to filing of a petition. If there were more attempts to work out voluntary debt repayments, fewer Chapter 7 bankruptcies would be filed. The use of counseling could result in helping debtors live on budgets and work out voluntary repayment plans.

Effect of Provisions: Without question debtors should attempt to work out debt repayment plans outside of bankruptcy. Unfortunately, by the time most debtors come to grips with their financial problems, it is too late to seek counseling. By preventing a debtor from initiating a bankruptcy case, the provision would result in many families being unable to stop foreclosures and repossessions, even though they may have the capacity to repay such debts. Since foreclosing creditors are confronted with substantial losses in a foreclosure, such a result is counterproductive to the goal of assisting in repayment of debts.

Page 462 PREV PAGE TOP OF DOC

Credit counseling should give debtors an opportunity to create a meaningful and realistic budget, obtain assistance and education in personal financial management, and put together a repayment plan that gives some return to creditors. Unfortunately a voluntary restructuring of debt requires the unanimous consent of all creditors and the refusal of one creditor to such a plan dooms the entire process. There are several major creditors that are unable or unwilling to participate in such a voluntary program.

Alternative: There should be created a means where the court can "hold up" a Chapter 7 bankruptcy and refer a filed case to consumer credit counseling, similar to a pretrial diversion program. Section 707 could be amended to provide that upon the request of any party in interest in a Chapter 7 case, or the court acting upon its own could suspend all time periods and deadlines in the case and refer the debtors to participate in a counseling program. If the counselor certifies that the program would be unsuccessful, the Chapter 7 could proceed. If the counselor does not so certify or if the debtors fail to participate in such a program, the case would be dismissed.

Since Chapter 13 debtors are participating in a voluntary repayment program under the supervision of the court and a trustee that requires the creation of a meaningful budget followed by counseling and educational programs during the pendency of the case, to require pre and post petition counseling seems to be duplicative. Since the goal of the provision of the bill is to encourage the creation of a budget that permits debtors to repay debts and such is accomplished in a Chapter 13 case, the requirement of consumer credit counseling seems most appropriate in a Chapter 7 case alone.

Page 463 PREV PAGE TOP OF DOC

The NACTT believes that the provisions of the bill noted above have the most serious impact on the viability of a strong Chapter 13 program. We can provide language to effect the alternatives proposed.

Our membership is ready to assist this Committee and its staff in finding alternative ways to achieve the goals of encouraging debtors to repay their debts to the best of their ability and to obtain a fresh start after making a meaningful repayment. Our members have been encouraging debt repayment and assisting families to repay their debts for many years. We can provide to you statutory language that will accomplish the goals of repayment and presentation of a system that works.

APPENDIX A

COMMENTS OF THE NATIONAL ASSOCIATION OF CHAPTER THIRTEEN TRUSTEES TO PROVISIONS OF H.R. 833

The various legislative proposals considered by both houses in the 105th Congress relating to bankruptcy reform all sought to restructure the balance between debtors and creditors and the balances between various groups of creditors in the bankruptcy process. The members of the National Association of Chapter Thirteen Trustees are standing trustees charged with the duty to administer cases filed under Chapter 13. The NACTT is deeply concerned over the process by which the rights between debtors and creditors and between different creditors are determined and enforced. The NACTT, however, believes that the restructuring of the balances between and among the competing groups are best left to Congress and the NACTT takes no position on those basic policy questions.

Page 464 PREV PAGE TOP OF DOC

Many of the provisions of the Conference Committee version of the bill would effect substantial and fundamental changes in the balances between debtors and creditors. In doing so, however, the bill also effects some substantial and damaging changes in the procedures employed. The NACTT believes that careful consideration of the means employed to reach the ends of re-balancing the positions of the parties could result in a more efficient, less costly means to accomplish the re-balancing. The NACTT has examined all of the provisions of H.R. 833 and offers our comments on these provisions.

Any bankruptcy reform undertaken by Congress should bear in mind several points:

1. The process employed to implement the rights of parties should be clear, functional, and impose the least transactional costs upon the parties.

2. The duties imposed upon Chapter 13 trustees must be reasonably capable of being accomplished.

3. Chapter 13 trustees must be provided the resources to accomplish the additional tasks imposed upon them under reform.

4. The provisions in the bill should actually accomplish the goals which motivated the enactment of the bill.

SECTION BY SECTION ANALYSIS:

Page 465 PREV PAGE TOP OF DOC

Sec. 102

In an effort to compel debtors with adequate income to repay debts, the bill amends 707(b) and *presumes* that a Chapter 7 case is an abuse if a debtor's monthly income, less IRS monthly expense allowances, less 1/60 of the debtors total priority obligations, less 1/60 of the debtor's total contractual payments to secured creditors, is at least 25% of the debtor's total unsecured debt. The debtor's income for the 6 months prior to filing is presumed to be the Debtor's income for this calculation.

Comment:

(a) The use of 707(b) as mechanism to impose a means test is less costly and cumbersome than a threshold test in every case (as contemplated by the H.R. 3150) and it is much more workable to administer. Use of the IRS allowances to calculate a debtor's family's reasonable living expenses is impractical because the IRS allowances currently include both expenses and debt payment. Thus, an allowance for "transportation" by the IRS is an allowance for gasoline, automobile maintenance, repair, and the cost of acquisition of an automobile. To the extent the Conference Report relies upon these allowances, even excluding payments for debts, the IRS figures are not appropriate. We suggest consideration of alternative methods to calculate presumptive living allowances for debtors such as regional average (median) expenses compiled by the Bureau of Labor Statistics (Consumer Expenditure Report).

(b) A debtor can demonstrate extraordinary circumstances requiring adjustment of presumed income. For example, where a debtor has recently lost employment or separated from a spouse, the debtor can show a reduction from the presumed income. Where, however, a debtor has recently experienced an increase in income, there is not a means to increase the debtor's presumed income. The situation often happens, since a bankruptcy filing may follow a debtor's re-employment.

Page 466 PREV PAGE TOP OF DOC

(c) The requirement that a *debtor's attorney* attest to the accuracy of any information used to seek an adjustment of presumed income would place a debtor's attorney in the position of fact witness in any hearing. This puts an attorney advocate in an impossible ethical dilemma. (See, e.g. N.C. Rule of Professional Conduct 5.2(b) requiring mandatory withdrawal of an attorney who would act as a witness).

(d) By making the *debtor's attorney* the guarantor of fees to a successful panel trustee, the bill penalizes an advocate for an adverse decision, would discourage pro bono representation of debtors, and would result in a substantial increase in pro se filings. While fee shifting might be appropriate (requiring the debtor to bear the trustee's fees and costs) requiring a debtor's advocate to bear the costs would discourage effective advocacy. The NACTT experience is that effective and competent advocacy on behalf of all parties reduces costs and makes the process more efficient. The additional burdens on debtors' counsel will cause many competent counsel to cease practicing consumer bankruptcy leading to less competent debtor representation.

Sec. 104

The bill would establish a pilot program for the development of a curriculum and materials to educate individual debtors on how to manage finances.

Comment:

The NACTT has long been a supporter of educational programs for debtors in Chapter 13 programs. Individual Trustees have implemented education programs across the country. The NACTT is encouraged that the legislation recognizes the work many trustees have done. We suggest that three districts will be insufficient for an effective analysis of the impact that education could have. We further suggest that the bill recognize those districts already having educational programs for Chapter 13 debtors be used as pilot districts.

Page 467 PREV PAGE TOP OF DOC

Sec. 107

This section enacts new Code §527 ("Debtor's Bill of Rights") which prescribes and proscribes certain conduct by a "debt relief agency" including an obligation to provide a written contract with an assisted person, to require disclosures in advertising and precludes certain actions by such services.

Comment:

Although a well intended effort to improve information available to potential bankruptcy candidates, this section would impose restrictions of advertising of lawyers who represent any debtors, even if the representation of debtors is not the customary practice of the lawyer.

Specifically the prohibition in the "Debtor's Bill of Rights" prohibiting an attorney from advising a prospective debtor to incur a debt in order to pay an attorney's fee *even* if the attorney is the creditor. The NACTT believes it to be inappropriate for a prospective debtor to incur debt in contemplation of a bankruptcy filing from a creditor unaware of the prospective filing. Such is not the case if the attorney extends credit in agreeing to perform services for a fee to be paid in installments from future income or from a family member of the debtor that extends such credit. The NACTT believes it to be in the best interest of the system to permit a reasonable attorneys fee and for it to be paid in installments. To the extent that this section would prohibit that, the NACTT believes the section should be modified.

Page 468 PREV PAGE TOP OF DOC

Sec. 110

If a debtor seeks to reaffirm wholly unsecured debt the debtor is to be advised that she has a right to a court hearing which may be waived if the debtor is represented by counsel.

Comment:

(a) Despite significant evidence of abusive practices prevalent in reaffirmation of debt, the bill makes little effort to curb such abuses. Reaffirmation of discharged indebtedness is a means whereby a debtor prefers one creditor over another, devoting post-petition income to satisfy the claims of that creditor to the exclusion of other, disfavored, creditors. Creditors often take advantage of ill-advised debtors in seeking and obtaining reaffirmations. Debtors may favor one creditor over another similarly situated creditor for no reason. There is currently no judicial supervision over such reaffirmation.

(b) The NACTT believes that *limiting* reaffirmations (such as reaffirmations of secured debts only) with complete information relative to the cost of credit proposed to debtors could serve to encourage more equitable repayment to all creditors, not simply limited to those the debtor seeks to prefer. The provision should clearly prohibit creditors from contacting debtors who are represented by counsel.

(c) Full disclosure of the cost of a reaffirmation should be required. Thus, a Regulation Z-type disclosure (15 U.S.C. §1601 et. seq.) and (12 C.F.R. §226) in which true costs of future credit are disclosed might result in a more careful review of the desirability of a reaffirmation of debt. See *In re Camps*, 217 B.R. 836 (Bankr. C.D. Cal. 1998).

Page 469 PREV PAGE TOP OF DOC

Sec. 116

This provision would make it a violation of the §524 post-discharge injunction for a creditor which has received payments under a plan of reorganization to fail to account for such payments in the manner provided for by the plan. A mortgage creditor, receiving both prepetition arrears payments and post-petition ongoing payments under a confirmed Chapter 13 plan must apply such payments appropriately. Failure to do so would result in a minimum damage award of $1,000. The section would prohibit the use of a class action to recover based upon a §524 violation.

Comment:

(a) The NACTT is encouraged by the proposed statutory obligation that creditors properly apply plan payments. Often at the conclusion of a Chapter 13 plan some creditors immediately initiate renewed collection activities against some debtors due to the improper accounting by mortgage servicing companies to properly apply debtors payments.

(b) Removing the ability to pursue actions under §524 by way of class action removes a tool to vindicate wrongs which, on a case by case basis, are relatively minor but taken as a whole are significant to the system. Such is also true in section 117 of the bill.

Sec. 119

This section seeks to curb abusive refilings by limiting the effect of the automatic stay. The provision involves the court in stay litigation very quickly upon a subsequent bankruptcy case. If a case is filed within one year of a prior case, the automatic stay would terminate 30 days after filing unless the stay were extended. The stay could be extended in such case only if the current case were filed in "good faith". A filing would be presumed to be lacking good faith if two or more prior cases had been pending within a year, a prior case was dismissed due to a debtor's failure to file documents, or if there had been no substantial change in the debtor's affairs.

Page 470 PREV PAGE TOP OF DOC

There would be no automatic stay if debtor had two prior cases dismissed within one year.

Comment:

(a) Although this section will spawn early litigation in a repeat filing case, the NACTT believes that it is feasible to approach repeat filing abuses by limiting the effect of the stay. The NACTT suggests that the burden on a debtor to extend a stay be the ability to prove, by a preponderance of the evidence, to propose a feasible plan. The NACTT would suggest that, in a repeat filing, the stay be lifted in a Chapter 13 case as to property subject to a lien only thereby protecting a debtor's *income* from collection activity, which would encourage the prompt implementation of a plan.

(b) In cases in which the debtor is possessed of property with equity which, upon liquidation, might provide assets to distribute to creditors, a Chapter 7 trustee will be required to participate in the stay extension applicable to a repeat filer. The NACTT would encourage the section to be modified to require the court clerk to advise any trustee if a case is filed as to which this section might apply.

Sec. 120

This section defines the method by which and the situations when *in rem* stay of relief would be appropriate.

Page 471 PREV PAGE TOP OF DOC

Comment:

The NACTT believes that adding *in rem* stay relief to the tolls that the court has to combat abuse is a benefit to the system.

Sec. 121

This section permits a debtor to retain personal property which secured a debt only if the debtor redeems the property or enters into a reaffirmation agreement.

Comment:

Although this provision is intended to clarify a conflict in the circuits and promote consistent outcomes in Chapter 7 cases, the provision should avoid expanding creditor's rights to repossess collateral beyond that provided in applicable nonbankruptcy law.

Sec. 122

This section would result in lifting of the stay as to property where the debtor failed to file a statement of intent relating to that property or where the debtor failed to perform that statement of intent.

Comment:

This section should not be applicable to debtors under Chapter 13. It is a Chapter 13 plan and its confirmation that governs the treatment of secured claims. Current rules do not require the filing of a statement of intent by Chapter 13 debtor. The NACTT suggests that the reference to Chapter 13 debtors be deleted. (p. 53, line 15)

Page 472 PREV PAGE TOP OF DOC

Sec. 123

This section would preclude confirmation of a Chapter 13 plan which provides for the release of a creditor's lien prior to the payment of both the secured *and* unsecured portions of the debtor or the discharge of the plan. Thus debtors could not get a title released after paying the secured claim if their Chapter 13 plans were not completed.

Comment:

(a) This provision seeks to protect the rights of partially secured creditors from the effect of a dismissal or conversion of a Chapter 13 case. Under current laws liens are revived, at the time of conversion or dismissal, to secure any indebtedness which remains unpaid. [This provision could increase litigation under §363 where a debtor, during a Chapter 13 case, after satisfying a claims secured by personal property, seeks to dispose of that collateral.] This provision would have minimal effect if the provisions of bill §124 are not modified (since few consumer secured debts could be "crammed down" under that provision). This appears to codify *In re Pruitt*, 203 B.R. 134 (Bankr. N.D.Ind. 1996) and reverse *In re Nicewonger*, 192 B.R. 886 (Bankr. N.D.Ohio 1996).

(b) Congress should make it clear that this provision is not to be construed to restrict a debtor's right to modify a plan, after satisfaction of a secured claim, based upon change circumstances, if such changes were proposed in good faith.

Page 473 PREV PAGE TOP OF DOC

(c) While cumbersome in some situations, the implementation of this provision would not seem to work a hardship on the system.

Sec. 124

This section would prohibit the "cramdown" of purchase money secured claims in reorganization plans under Chapter 11, 12, or 13 if the tem securing the obligation had been acquired within five years of the filing of the petition. This would require any claim secured by property purchased by the debtor within five years to be paid in full, with interest and charges, in a Chapter 12 or 13 plan. To redeem property subject to a PMSI under section 772 of the Code, a Chapter 7 debtor would be obligated to tender the entire debt balance to the purchase money creditor, irrespective of the value of the property redeemed.

Comment:

Debts are basically of two kinds: debts which are backed by collateral (secured) and debts that are backed by no collateral (unsecured). A creditor with a secured debt would, under most state laws, be entitled to foreclose on the collateral securing the debt upon default, recovering for its benefit whatever the property is worth and would be entitled to pursue the debtor, personally, for any balance that might be due. Bankruptcy has long recognized this clear distinction, allowing a debtor to retain property securing an obligation provided that the debtor pays to the creditor the present value of the property securing the claim. This has preserved a creditor's right to receive what it would have realized had it foreclosed on its collateral and utilized the proceeds from the foreclosure.

Page 474 PREV PAGE TOP OF DOC

Creditors which extend purchase money credit secured by rapidly depreciating collateral or extend credit beyond the reasonable value of the collateral are actually extending both secured and unsecured debt and knowingly assume a measure of risk by doing so. Thus a bank rolling a negative value of an automobile trade-in into its finance contract, or a retail financier selling a refrigerator relies upon both the value for the secured option of the obligation and the creditworthiness of a debtor for the unsecured portion of the obligation beyond that amount. This provision attempts to shift the consequences of poor credit decisions from the creditor to the debtor.

This section would require debts which have any element of a purchase money security interest as part of the debt to be paid *in full* in a Chapter 11, 12, or 13 plan. The debt amount in excess of the value of the collateral—even though unsecured under state law—would have to be paid in full while other unsecured claimholders, such as medical bills, or credit card would receive *substantially* less.

The NACTT believes that this provision is counter-productive and severely damaging to the consumer bankruptcy system for the following reasons:

4. The provision would treat similar claims—unsecured claims—dissimilarly, substantially eliminating the current method of treating claims of an equal class equally.

5. The provision would deprive many farmers the opportunity to reorganize their operations which currently is available to them under Chapter 12. Because crops and livestock can have broad fluctuations in value, to treat a purchase money secured creditor as if the collateral has a greater value than it actually does would force farmers to restructure under artificial conditions rather than current market conditions. This undermines the intent and effect of Chapter 12.

Page 475 PREV PAGE TOP OF DOC

6. The provision would prevent the redemption of small personal property items which are subject to purchase money security interests since the law would require the entire balance due to a creditor to be paid in full to retain a small item of furniture or appliance, many of which are needed by debtors and their families. The true value of a four-year old refrigerator in any market is far less than its original purchase price.

7. The provision would discourage the filing of Chapter 13 cases over Chapter 7. Some trustees have estimated that 2/3 of case *currently* filed under Chapter 13 would file under Chapter 7. Since a reaffirmation at a *full debt amount* would actually costa debtor *less* than a Chapter 13 plan under this Section, debtors would be economically encouraged to elect Chapter 7 relief over Chapter 13 relief—a result that appears to be counter to all of the public pronouncements of the sponsors.

The limitation on the length of a Chapter 13 plan, coupled with this provision removes any real benefit to "restructuring" indebtedness.

8. The bill would discriminate against sole proprietors in favor of close corporations, since treating a claims as secured only to the extent of value in a reorganization would be available to a corporate Chapter 11.

The NACTT believes that if the "abuse" this section seeks to eliminate is debtors improperly financing the purchase of items immediately prior to filing bankruptcy, there are far less damaging solutions to consider, such as prohibiting a debtor from retaining *any* item purchased within 90 day s of a bankruptcy filing which is subject to a security interest or precluding a reduction in interest rate ("present value") of any secured debt incurred within 90 days which would preserve the earning ability of the asset.

Page 476 PREV PAGE TOP OF DOC

Sec. 125

This section would codify and expand the holding of the Supreme Court in *Associates Commercial Corp.* v. *Rash*, U.S. 117 S.Ct. 1879, 138 L.Ed. 2d 148 (1997) by recognizing that the method of valuation of property is from the view of the debtor ("what would it cost me to replace this item") as opposed to the creditor ("what could I get for this item if I sold it.").

Comment:

Any provision which artificially inflates one class of claims (secured claim) beyond a reasonable amount, results in a reduced distribution to general unsecured creditors and makes more difficult a debtor's attempt to pay those unsecured creditors that Congress has determined should be paid in full—tax obligations, support arrearages, etc. To the extent Congress believes that all secured claims belong to such a privileged class, the provision does not do damage to the system. In so doing, Congress should be aware that fixing value at the debtor's cost to buy it from a retailer would "charge" a debtor for items that the Supreme Court excluded, such as dealer warranty costs and dealer overhead.

Sec. 126

This provision modifies §522(b)(2)(A) as to the ability of a debtor to elect exemptions in a bankruptcy. This section appears to be subject to two possible interpretations. Under one interpretation of this amendment, persons who move into an "opt out" state withing two years of filing bankruptcy would not be entitled to *any* exemption. Another interpretation of the section indicates that person who move into an "opt out" state within two years of filing a petition would be entitled to federal exemptions.

Page 477 PREV PAGE TOP OF DOC

Comment:

The NACTT encourages Congress to apply a principled means of limiting exemption shopping prior to filing. If establishing uniform exemptions is not feasible, a limitation and floor on exemptions might be appropriate. The current language of this section, however, is clearly ambiguous and neither of the two possible interpretations appears to resolve the issues raised by the bill's sponsors.

Sec. 129

This section would substantially eliminate the super discharge in Chapter 13, specifically excepting from such discharge debts resulting form "fraud" (although debts of a kind listed in §523(a)(2) are far broader than what conventional understanding would label "fraud"), defalcation while acting in a fiduciary capacity, student loans, restitution, fines, willful and malicious injury to persons, and all obligations not scheduled in the petition.

Comment:

(a) The elimination of the super discharge removes a major incentive for some debtors to embark on a Chapter 13 plan. Most debtors who choose Chapter 13 motivated by the broad discharge, do so, not because they believe that they owe debts which are of a kind in §523(a)2), (4), (8), (9) and part of (6), but rather to avoid the tremendous legal and personal cost of defending an action brought under such section. Such debtors in effect propose to pay to their creditors the costs of litigation.

Page 478 PREV PAGE TOP OF DOC

(b) The enactment of this provision in its current form would necessitate repeated potentially unnecessary adversary litigation since a creditor which believes it holds a nondischargeable claim must initiate a complaint under §523(c) within 60 days of the meeting of creditors, even if it is satisfied with the treatment of its claim in a proposed Chapter 13 plan. A creditor must do so to protect from subsequent unfavorable modification of the plan.

(c) The NACTT would suggest that this provision be modified to compel the court to consider whether the debtor is seeking to discharge a debt of a type described in §523(a)(2)(4) or (6) during the confirmation process. If the court finds that the plan would discharge an obligation of a type described in §523(a)(2)(4) or (6), the court should be permitted to condition confirmation upon the debtor committing all disposable income to a plan for a period longer than three to five years. This might allow plans, in limited situations, to exceed 60 months in length but such would be more cost effective to administer, would increase distributions all creditors and would still preserve a fresh start to debtors.

Sec. 132

This provision would exclude from the definition of disposable income any funds received by the debtor on behalf of a minor child for child support, foster care or disability benefits. The provision effects no change to the definition of expenses.

Comment:

This provision permits a debtor to shelter from his or her gross income any support payments but leaves untouched the ability to subtract from such gross income the expenses incurred to maintain the child for whose benefit the income is received. While well intended, the provision would allow any debtor receiving support to shelter any such income from a Chapter 13 plan, even if the debts to be paid and/or The discharged were incurred for the benefit of the minor child (such as medical bills). The NACTT believes that the purpose of this provision would be better served by requiring the court to consider, as part of an all disposable income analysis, whether the debtor has included in income funds received for child support and should *preclude* a debtor from applying to a Chapter 13 plan any funds needed to support the dependent of a debtor.

Page 479 PREV PAGE TOP OF DOC

Sec. 133

This provision would lift the co-debtor stay automatically 30 days after the filing of a Chapter 13 petition as to a nondebtor that received consideration from the creditor or as to property not retained by the debtor. The stay would *not* lift if the debtor became obligated to satisfy the cosigned claim by virtue of a separation agreement or divorce decree.

Comment:

Current law requires the court to lift the co-debtor stay to the extent the debtor did not receive the consideration for the debt or the Chapter 13 plan fails to provide for the cosigned obligation in full (§1301(c)). This provision seems to make the need to obtain court relief unnecessary.

The NACTT notes that because creditors are mostly unaware as to whether a separation agreement or divorce decree has imposed an obligation to pay cosigned debts on the debtor not receiving the consideration, creditors will often be unaware as to whether the co-debtor stay remains in existence. Most creditors, to avoid violating the stay, will still seek relief from it.

Further, since no provision is made for a court to extend the 30 day stay where the debtor did not receive the consideration, there appears to be little reason for a 30 day stay at all.

Page 480 PREV PAGE TOP OF DOC

The existence of this provision does not appear to harm the system, and the NACTT suggests that its impact will be minimal.

Sec. 135

This provision would create a *presumption* that debts to a single creditor aggregating more than $250 for luxury goods or services incurred within 90 days are not dischargeable.

Comment:

Since, by operation of Section 129 of the bills this presumption would also apply in Chapter 13 cases, the NACTT is concerned because the section fails to indicate how such "presumption" can be rebutted. If the intent is to make all debts incurred within 90 days of a filing nondischargeable unless such debt was incurred to acquire goods or services reasonably necessary for the maintenance and support of the debtor or the debtor's dependents, the provision ought to be drafted in absolute terms. The NACTT assumes that this presumption could be rebutted by proof by a debtor of an intent to pay the debt when incurred.

Sec. 136

This provision states that any lease of personal property not assumed in a confirmed Chapter 13 plan is rejected as of the end of the confirmation hearing.

Page 481 PREV PAGE TOP OF DOC

Comment:

This would codify the practical effect applied in most jurisdictions, usually as a provision of an order confirming a Chapter 13 plan. The NACTT supports this provision.

Sec. 137

This provision would require Chapter 13 debtors to continue to make contract debt payments to creditors holding purchase money security interests in property of the debtor and continue to make contract payments to lessors of personal property after the filing of the petition and would require these direct payments to continue until "the creditor receives actual payments" under the plan. The direct payments to creditors required under this provision would be required in addition to play payments to the trustee which must be all disposable income.

Comment:

The NACTT believes this provision to be a major impediment to effective administration of the consumer bankruptcy system and will cause substantial hardship and cost to the courts, trustees, and participants to the process. Since any income the debtor might receive (except support payments pursuant to Section 132 of the bill) less the living expenses of the debtor or the debtor's dependents must be dedicated to fund the plan, it is under from where these direct "contract payment" amounts would come.

Because the debtor would be the statutory disbursing agent under this provision and because the claim held by the creditor would be the amount owing to the creditor at the time of the filing, it would be difficult for a trustee to determine the balance due to the creditor after confirmation or at the time when the creditor begins to "receive actual payments" under the plan. At the very least, if this provision were law, affected creditors should be required to file a second proof of claim or a formal accounting reflecting the reduction in its claim by the direct payments, failing which the claim could be denied following notice and an opportunity to be heard.

Page 482 PREV PAGE TOP OF DOC

Since undersecured creditors are not entitled to interest between filing and confirmation, the application of a debtor's direct payments would need to be verified to assure accuracy to the claim balance. Trustees would have no choice but to require an accounting to be certain that no portion of a payment to an under-secured claimholder had been applied to interest or would need to object to claims to obtain accurate balances. This provision would substantially increase trustee's costs of operation and reduce dividends paid to unsecured creditors.

Direct payments by debtors would deprive trustees of funds necessary to administer the system. Since, by operation of 28 U.S.C. §586(e)(2), a trustee is entitled to a commission only on payments received under plans, the trustee would not be entitled to commissions on payments made by a debtor directly. Because the bill substantially increases the responsibilities of the trustee, any consumer bankruptcy system must provide for sufficient resources to permit trustees to meet those responsibilities. This provision undermines the ability to provide resources.

An effort by the NACTT to identify the abuse that this provision was intended to correct led to two issues: 1) deferred confirmation of Chapter 13 plans prevents early distribution of funds to secured creditors; and 2) front-loading of debtor's attorneys' fees in plans precludes prompt distribution of funds to secured creditors. The NACTT suggests that modifications to 11 U.S.C. §1321, and 1326 can solve those concerns without such a disruptive effect on the system.

The changes we suggest would:

Page 483 PREV PAGE TOP OF DOC

1. Insure prompt confirmation of uncontested plans (see Section 605(a) of the bill).

2. Preclude the front-loading of attorneys fees in Section 1326(b).

3. Require trustee to pay funds on hand to secured creditors if a case is dismissed or converted prior to confirmation, instead of returned to a debtor under Section 1326.

Sec. 140

This provision would extend the period between Chapter 7 discharges from six to eight years and would prohibit the discharge of debt in a Chapter 13 case filed within five years of filing an earlier Chapter 13 case which reached discharge.

Comment:

The NACTT is unaware of any abuses in Chapter 13 filing what would require a five year period between a first filing and a re-filing when the first case is consummated. Often debtors encounter significant economic problems after a Chapter 13 discharge through no fault of their own.

The NACTT would encourage a modification of this provision which would prevent discharge "unless such prior discharge was entered under §1325(a) after consummation of a plan which paid a dividend of at least 70% of allowed unsecured claims." Such a window of opportunity, roughly parallel to §727(a), would further encourage higher dividend of Chapter 13 plans.

Page 484 PREV PAGE TOP OF DOC

Note that Section 119 of the bill already imposes significant protections against repetitive filing abuses.

Under the bill, a debtor would not be precluded from obtaining a Chapter 7 discharge within five years of a 70% Chapter 13 discharge but *would* be precluded from obtaining a discharge, even in a high dividend Chapter 13 case filed within five years of the filing of an earlier case irrespective of the debt repaid in the earlier case. Such appears to be expressly contrary to the stated intent of the conference committee.

Sec. 142

This provision would make support obligations a first priority, paid ahead of the costs of administration.

Comment:

This provision would prevent the administration of asset Chapter 7 cases if there were a support obligation to be paid, since a Chapter 7 trustee could not compensate auctioneers or sales agents. This would have the effect of harming that class of creditors the provision was intended to help. The NACTT suggests making this priority a second level priority.

Sec. 143

This provision requires that a debtor be current on all post-petition support payments to obtain confirmation of a Chapter 13 plan or to obtain a discharge under 1328(a).

Page 485 PREV PAGE TOP OF DOC

Comment:

The NACTT endorses the principle that debtors who are obliged under state law to pay support make such payments as a condition to obtaining relief under Title 11. Some Chapter 13 trustees are actively involved in assisting support creditors in collecting the post-petition support payments that are due them. The section should be modified to provide, as an alternative, that if the trustee has sufficient funds to make all post-petition support payments to a support creditor in the trustee's first disbursement, confirmation can be effected.

Sec. 203(d)

This provision would preclude any Chapter 13 plan from modifying any loan by a debtor from his or her qualified pension fund.

Comment:

This provision would statutorily overrule the Sixth Circuit decision in *In re Harshbarger*, 66 F.3d 775 (6th Cir. 1995) which held that funds used by a debtor to replenish his pension fund after the debtor had "borrowed" from the fund were disposable income which must be used to fund a plan. *Harshbarger* has had a damaging effect on debtors forced to not repay such pension loans due to the tax and penalties imposed. The provision would permit a debtor to shelter income, otherwise subject to distribution to creditors, if the debtor had borrowed such funds prepetition. This provision would have the effect of permitting some Chapter 13 debtors to reduce disposable income by imaginative pre-bankruptcy planning—such as by "borrowing" funds from a pension to pay a nondischargeable but non-priority debt, or to purchase exempt property.

Page 486 PREV PAGE TOP OF DOC

Sec. 302(a)

This section would make ineligible for *any* bankruptcy relief any individual who had not, within 90 days prior to the bankruptcy filing, participated in a consumer credit counseling program certified by the United States Trustee. This pre-filing obligation would not apply if credit counseling services are not able to provide service due to geographic limitations or an inability to provide counseling services within five days of a request.

Comment:

Unlike the House version of 3150, this provision does not permit access to the bankruptcy court in emergency situations confronting debtors, such as imminent foreclosure, wage garnishment, asset attachment or levy. While pre-bankruptcy counseling ought to be encouraged and rewarded, denying families fully capable of proposing a repayment plan under Chapter 13 the opportunity to reorganize is of dubious benefit.

Trustees from across the country have warned the NACTT of both the inability of current non-profit consumer credit counseling agencies to handle the demand that this provision would impose and the serious risk of unscrupulous and profit-oriented programs entering the system. Even with the screening offered by the United States Trustee Program, without guidance it is uncertain whether standards for certification will vary from district to district and can be effectively policed. The provision should be applicable, if enacted, on a county to county basis.

Page 487 PREV PAGE TOP OF DOC

The NACTT suggest that the pre-bankruptcy counseling requirement be encouraged but not mandated on a debtor seeking relief under Chapter 13, provided the obligations of Section 302(c) are maintained (which requires that debtors attend an educational program as a condition to receiving a discharge under §1328). Often by the time a debtor needs bankruptcy relief, the amount of the debtor's debt balances and the arrearages that have accrued on secured debts preclude effective voluntary debt "restructuring." The bankruptcy process can effectively work towards educating consumers to help prevent *future* credit mistakes. Several trustees have extensive and successful education programs which reduce recidivism and encourage completion of plans.

Sec. 302(c)

This provision would deny a discharge to any Chapter 13 debtor who had not completed an instructional course in personal financial management, unless the U.S. Trustees certifies that approved instructional courses are not adequate to serve the demand.

Comment:

This provision appears to directly conflict with section 104 of the bill which contemplates a pilot program for post-petition educational programs in three judicial districts. While the NACTT supports the use of educational programs in personal financial management, the nature of such educational programs the impact and efficiency of the curriculum should be tested by the pilot program contemplated in section 104 of the bill.

Sec. 302(g)

Page 488 PREV PAGE TOP OF DOC

This provision has the effect of extending the protections afforded to mortgage creditors under Section 1322(b)(2) to lenders with liens on condominiums, co-op interests, and mobile homes.

Comment:

This provision clarifies the conflicting holdings in which some home mortgage creditors are subject to modification and some home mortgage creditors are not. Clarification of these conflicts are welcome by practitioners, and the NACTT endorses the resolution.

Sec. 601

This provision reverses the holding in *In re Maloney*, 209 B.R. 844 (Bankr. M.D. Pa. 1997) in which non-attorneys were not permitted to represent creditors in meetings of creditors. It would specifically allow non-attorney advocates to appear and participate in §341 hearings on behalf of creditors.

Comment:

In most jurisdictions non-attorneys and paralegals participate in §341 hearings, acting on behalf of creditors. Most Chapter 13 trustees endorse this, noting that the efficient and low cost of participation of creditors at a Chapter 13 §341 meeting through paralegals, employees, and agents can facilitate the prompt and cost effective administration of cases.

Page 489 PREV PAGE TOP OF DOC

Sec. 602

This provision would require the U.S. Trustee to establish the means to conduct random audits of debtors' schedules and statements in 1 out of 250 cases *and* would mandate audits for any case in which the income and expense disclosure for a debtor "reflect greater than average variances from the statistical norm" in the district. The audits must be conducted in accordance with generally accepted auditing standards.

Comment:

The NACTT endorses the concept of accountability for the veracity of schedules and statements and the requirements that there be a mechanism to test their accuracy. The use of "G.A.A.S." to describe an "audit" would specify an expensive, detailed examination of debtors' disclosures and such detailed examination would be required in *every* case in which a debtor's expenses deviated from an undefined statistical norm. There is no indication as to how many bankruptcy debtors have expenses which deviate from the statistical norm. The substantial cost of this requirement is unknown and its cost is unfunded. The NACTT suspects the costs to be significant.

Sec. 603

This provision would require notices to include account numbers and be mailed to the address as specified by the creditor. The failure of the notice to include the account number, the debtors address and the debtor's social security number could invalidate the legal effect of the notice.

Page 490 PREV PAGE TOP OF DOC

Comments:

In order to assure finality and expect bankruptcy decisions to be binding upon all parties, bankruptcy notices must be effective to reach all affected entities. Affording creditors certain rights in consumer bankruptcy cases is less effective when, as a practical matter, they are foreclosed from asserting those rights due to a lack of notice. It is, however, *impractical* to expect a debtor and the creditor indicated. It would be appropriate, however, to require the notice given to the creditor to include the account number that is listed in the last communication before the filing of the petition and provide notice to the address specified in that communication.

The use of a "standard" address of a creditor is a good idea. Clerks and trustees providing such notice, however, would be required to make difficult choices as to whether a creditor listed on a petition is the creditor as to which a "standard address" is to be used. The similarity of creditor names (particularly among banks), may divert notice from the creditor to which it was intended. For example, notices provided to BankOne which is located in Louisville, Kentucky would not be effective as to BankOne located in Dayton, Ohio. If a debtor listed a branch address of BankOne, which "standard address" should be used? The importance of prompt application of the automatic stay cannot be overstated. In proposed §342(f), notice is not effective notice until it is *received* by the person or department responsible for bankruptcy notices. It will be up to the creditor to establish a reasonable procedure. The NACTT questions whether a legal result (the delivery of notice) should depend upon a process established (or not established) by the party against whom it is applied.

Page 491 PREV PAGE TOP OF DOC

Sec. 603(b)

This provision would require all debtors to file, with the petition, schedules and statements, copies of 3 years of tax returns and copies of pay stubs.

Comment:

Currently, any trustee may obtain a debtor's tax returns or pay stubs where such is needed or requested. To require the filing, storage and distribution of such documents in every case may impose an unrealistic burden on the clerk of each court. If filing is required, the bill should require clerks to provide such documents to trustees administering cases.

The NACTT questions how tax returns can be filed with the court in each case, be effective tools for trustees and creditors, and still be confidential as contemplated in proposed amendment to §521(g)(1) contained in this section.

Sec. 604

This provision would result in the automatic dismissal of any petition where the debtor fails to file the documents required under §521.

Comment:

While the NACTT endorses the prompt disposition of cases when debtors do not perform the tasks the Code requires of them, it is inappropriate to have a case "automatically" dismissed if a Chapter 7 trustee discovers assets which might be available for distribution to creditors particularly if the asset might be available for creditors only in bankruptcy, such as a preference or a fraudulent conveyances. The NACTT suggests that the dismissal be effective unless objection is raised by the trustee.

Page 492 PREV PAGE TOP OF DOC

Sec. 605(a)

This provision requires confirmation hearings to be held no sooner than 20 nor later than 45 days after the meeting of creditors.

Comment:

Prompt confirmation of uncontested Chapter 13 cases is important to making Chapter 13 effective for both creditors and debtors. The NACTT suggests that cases in which no objection to a Chapter 13 plan is raised could be confirmed earlier than 20 days allowing for more prompt distribution of funds to creditors.

Sec. 605(b)

This provision extend the period of time in which a debtor can file a Chapter 13 plan from 15 days (see Rule 3015 F.R.B.P.) to 90 days after the filing of the petition.

Comment:

The NACTT suggests that this provision unreasonably delays confirmation, delays first payments to creditors, and would work a serious hardship on the system. The NACTT endorses retaining the current 15 day deadline a to file a Chapter 13 plan.

Sec. 702(d)

Page 493 PREV PAGE TOP OF DOC

This provision would require the preparation of greatly expanded final reports in Chapter 13 cases, including an accounting of "claims asserted" (as opposed to allowed claims), the date of "each modification" of a plan and a listing of "defaults by the debtor."

Comment:

It is unclear why some of the information requested would provide much assistance for statistical record keeping or would be of benefit to creditors, parties in interest or the court system. Note that *significant* computer reprogramming would be required for Chapter 13 trustees to prepare such reports. This cost to the system has not been quantified, but clearly work to increase administrative costs and reducing dividends to unsecured creditors.

Sec. 807

This provision would except from discharge under Chapter 13, tax obligations listed in 523(a)(1).

Comment:

Chapter 13 currently requires priority tax claims to be paid in full. The NACTT endorses a proposal to accord similar treatment to taxes resulting from unfiled or fraudulently filed tax returns, irrespective of the age of such tax obligation. The provision as drafted, however, would significantly erode the fresh start and/or would reduce funds distributed to general unsecured creditors. Because this provision would make tax obligations nondischargeable, post-petition interest which accrues on taxes would *also* be nondischargeable but could not be included in the prepetition claim. Thus, while taxes are paid in Chapter 13 cases (as they are now), interest would continue to accrue on the taxes and the debtor would *not* be able to pay interest during the plan. Even in jurisdictions where such interest could be paid in a Chapter 13 plan, funds distributable to general unsecured creditors would be diminished.

Page 494 PREV PAGE TOP OF DOC

Sec. 816

This provision would preclude confirmation of a Chapter 13 plan if a debtor had not filed all pre-petition tax returns.

Comment:

The NACTT endorses the requirement that the law require tax returns to be filed. If, however, a debtor fails to file a tax return resulting in the denial of confirmation of a Chapter 13 case and its dismissal, all funds (except allowed administrative claims) would be returned to the debtor. The NACTT questions whether it might not be more appropriate to permit the dismissal of the Chapter 13 case if the debtor fails to file all delinquent returns within six months of the petition date and the tax creditor thereafter files a notice of the debtors failure to file a return. If a case is confirmed but subsequently dismissed, the funds held by the trustee could be disbursed to creditors.

Sec. 1130

This provision provides procedural protections to private trustees, availing judicial review to such trustees when they are terminated or cease to be assigned cases. It also provides for judicial review of decisions of the U.S. Trustees in denying a Chapter 13 trustee's request for approval of actual and necessary expenses.

Comment:

Page 495 PREV PAGE TOP OF DOC

The NACTT has long been an advocate of prompt judicial review of actions of the U.S. Trustee that can have an impact on the efficient operations of a Chapter 13 trustee's office. This provision helps provide such review and the NACTT believes it to be appropriate and beneficial to the system.

Mr. **GEKAS.** The chair allots to itself 5 minutes for a round of questions.

Judge Newsome, I have no objection, I want to say at the outset, of putting in some waiveability of the requirements that we now put on that you complained about with the $7,800 or $600 a month earner like the costly features of that.

Would you feel better if we had some kind of waiver for which the debtor could apply when the income is even lower than a lower stage of median income, to such an extent that would be foolish for us to delve into all of the other circumstances?

Mr. **NEWSOME.** Mr. Chairman, the point of my remarks is that, by the time most of these people file for bankruptcy, credit counseling is not going to do them any good, except for this, it is to keep them out of the second bankruptcy.

Mr. **GEKAS.** Well, that is—why wouldn't that be important?

Mr. **NEWSOME.** It is important, very important.

Page 496 PREV PAGE TOP OF DOC

Here is my suggestion. My suggestion is, if you want to do mandatory credit counseling, why don't we do it this way? We already have them at the first meeting of creditors. The debtor has to show up at the first meeting of creditors, get interrogated by the trustee. Why not make them stay an extra hour and have a mandatory program that they have to attend on just the basics of financial management and then offer that as an introductory program? If they want more, the U.S. trustee offers a program that——

Mr. **GEKAS.** After they file, you are saying?

Mr. **NEWSOME.** That is right. Because it is not going to do anybody any good——

Mr. **GEKAS.** This is like our drunk driving laws where we have the education features after the offense is committed.

Mr. **NEWSOME.** That is right. And to make it compulsory—there are a lot of people that would say to make it compulsory it will be like sending them to traffic school. But I say there is nothing wrong with saying to them you have to stay an extra hour after the first meeting and you have to have this as a condition of discharge. And then if they want more, the U.S. trustee can show them where the door is to find more credit counseling, which is already in your bill, Mr. Chairman.

Mr. **GEKAS.** We will look at that. I don't want to start out by punishing the low-income person——

Page 497 PREV PAGE TOP OF DOC

First, I think I am trying to help that low-income person by applying those safety guards, the median income and all of that, so that we can safeguard their right to have a fresh start. That is one of the purposes of our bill. But if you say it is even more costly and hampering that prospect if we put these other conditions in, I am looking toward some kind of waiver or change of position in the way we are going to conduct the counseling, et cetera.

Mr. **NEWSOME.** May I make just one more comment along those same lines?

Mr. **GEKAS.** Yes.

Mr. **NEWSOME.** If you want—why have them file the tax returns? That puts a huge burden on our——

Mr. **GEKAS.** I must tell you we went over that so thoroughly that we have got to try to put a kind of a guard on all our bankruptcy proceedings. I think that is an important step.

Mr. **NEWSOME.** Let me finish——

Mr. **GEKAS.** But, again, we can put in proper places the waiver of that necessity. If a person has only Social Security income, then at the outset, if that is made known, maybe we can waive the necessity of a tax return.

Mr. **NEWSOME.** I think they ought to have to bring their tax returns to the first meeting, not file them. Why not have them bring the tax returns with them to the first meeting of creditors and, if a trustee wants to look at them, the trustee can say, where are your tax returns? And at that point the debtor can give whatever explanation is appropriate, rather than filing them, which creates a huge administrative burden for the clerk's office.

Page 498 PREV PAGE TOP OF DOC

Mr. **GEKAS.** We will take that into consideration.

The other thing that—and I read your testimony last night. Now I can't find it. I just had it. Is this it? Yes.

I got the impression from some of your comments that what our bill would do is to create more cases, et cetera, and, therefore, burden the courts; is that correct?

Mr. **NEWSOME.** Not more—it may or may not create more cases, but it will certainly create more litigation.

Mr. **GEKAS.** Okay. More litigation. It will create more litigation.

And then you say, real reform in the bankruptcy system will only arrive when those that make statements under oath in their bankruptcy filings are held to account for them.

So what you are saying is, under the current system, if we really enforced it and really tried to do a good job, we would have each case subject to oath, investigated, looked at and have litigated outcomes? I see no difference.

Mr. **NEWSOME.** No, that is not what I am saying.

Page 499 PREV PAGE TOP OF DOC

Mr. **GEKAS.** How do we put real reform in where the oath is going to be the core of this without having litigation or some way to test it in the court system?

Mr. **NEWSOME.** Mr. Chairman, we can't get the U.S. attorneys to bring any criminal prosecutions. Every bankruptcy judge in this country—I think that is an overstatement. Almost every judge in this country will tell you one of the big frustrations we have in the system is we make referrals, as we are required to do under title 18, to the U.S. attorneys; and they don't bring prosecutions.

You don't have to bring a million prosecutions to clean up the system. You need, however, to make it clear to people that you just can't file willy-nilly anything you want that says anything, without the threat that you may be criminally prosecuted for. That is the point of my statement. I am not talking about millions of criminal cases.

Mr. **GEKAS.** We want to have honest filings.

Mr. **NEWSOME.** Yes, we do.

Mr. **GEKAS.** And you want to, under the current system, refer them to the criminal courts. We want to bring tax returns in and do some other things that will stabilize the system. We probably have the same goal.

Mr. **NEWSOME.** We absolutely have the same goal.

Mr. **GEKAS.** But we want to bring about reform, even in the structure, which you seem to be reluctant to accept. I understand.

Page 500 PREV PAGE TOP OF DOC

Mr. **NEWSOME.** All right.

Mr. **GEKAS.** The time of the chair has expired.

The gentleman from North Carolina.

Mr. **WATT.** Thank you, Mr. Chairman.

I want to thank all three witnesses for bringing some real world views to this discussion and the people who are in the trenches every day. I regret that the administration didn't see fit to send over their administrator so we could get input from them. But, apparently, they didn't see fit to do that.

One of the concerns that I have had expressed to me about these credit counselors, is that we are about to set in motion something that will create a bunch of credit counselors out there that don't exist, that don't have any standards, you know, that we are getting ready to create a credit counseling industry. I don't have the background in bankruptcy to be able to evaluate whether that is a legitimate concern or not. Would you all care to comment on that, please?

Mr. **HILDEBRAND.** I would like to comment, Mr. Watt.

Right before H.R. 3150 looked like it was going to become law and, if you recall, it did not have a deferred effective date, so the practitioners in the Middle District of Tennessee, were very concerned about the impact that it would have. They had arranged to contract with a van service that would pick debtors up at an attorney's office, take them to a consumer credit counseling office, where they would either watch a video or talk to somebody, get a certificate and go back to the attorney's office so they can file the bankruptcy.

Page 501 PREV PAGE TOP OF DOC

Mr. **WATT.** Were the attorneys—I mean, some people have suggested that the attorneys will kind of create their own little credit counseling fiefdoms, and it will all get very incestuous, so to speak. Is that a concern?

Mr. **HILDEBRAND.** It is certainly a fear, Mr. Watt. Under the bill, H.R. 833, the U.S. trustee would have to certify the qualifications of the consumer credit counseling system and then, of course, certify whether it is geographically available.

Mr. **WATT.** I am still looking at this bill. I am still trying to get on the ground on this bill. So does the bill talk about the qualifications or do the trustees have the discretion to just decide whether this is adequate or not adequate?

Mr. **HILDEBRAND.** The U.S. trustee has to decide the qualifications, and the U.S. trustee would have to issue the certificate of qualifications.

Mr. **WATT.** So the qualifications may vary from place to place, depending on the trustee and what that trustee thinks is adequate?

Mr. **HILDEBRAND.** Yes, sir.

Mr. **WATT.** Okay. Judge Newsome, I was quoting you yesterday before you got here, some of the information that my staff had obtained on this credit counseling issue.

Page 502 PREV PAGE TOP OF DOC

But on another issue, according to the information I had, you had expressed a concern about section 111, the alternative dispute resolution section, that it would promote gamesmanship and embroil the court in intractable credibility disputes between debtors and creditors. Could you—do you care to elaborate on that further?

Mr. **NEWSOME.** Well, here is what I am concerned about. I am not an expert on credit counseling. Thank goodness, I never had to go to one, I guess. But, in any event, what I am concerned about is, first of all, that this bill does very little about bankruptcy petition preparers, and they are the bane of our existence in California. And what I am mainly concerned about is that the bankruptcy petition preparers will also get into the credit counseling business.

Now granted they have to be approved by the U.S. trustees, but these are people that, if you give them $125, they will file a bankruptcy whether you need it or not. And that is where, by the way, most of our 707(b) motions come from, substantial abuse motions, is because they have put people into bankruptcy that may not even need to be there.

But the point is that, if you keep 111 in here, first of all, it doesn't require that there be a written offer to the creditor. It just requires an offer. That could be something over the telephone. The game is going to be that we will—that the credit counselors, unscrupulous ones, I think, might go out and start blanketing creditors with offers to compromise for 60 cents on the dollar, which I think is the standard in the statute.

And then I end up having to unscramble the egg about who said what to whom and whether or not the creditor unreasonably refused to negotiate a repayment plan of some sort. That is an invitation for me to have a whole lot more work to do, just that section alone, than I already have.

Page 503 PREV PAGE TOP OF DOC

So I think it is a very serious problem; and I think, frankly, this doesn't help anybody. This section just doesn't help anybody.

Mr. **WATT.** Thank you, Mr. Chairman.

Mr. **GEKAS.** The gentleman's time is expired.

Does the gentleman from New York seek time?

Mr. **NADLER.** Yes, I do.

Mr. **GEKAS.** The gentleman is allotted 5 minutes.

Mr. **NADLER.** Let me first express my regret, as I understand Mr. Watt did, that the U.S. Trustees' Office has been prohibited by the Department of Justice from testifying at this hearing. I think that the Department of Justice is prohibiting them from testifying is just as reprehensible as the CBO prohibiting its expert from testifying, and I wonder what is going on here.

But in any event, Judge Newsome, you stated in your testimony that—let me just read from it, that the means test and other—the means test would require 85 percent of chapter 7 filers to complete and file an additional seven or more sets of forms and documents beyond what they are now. The means test will substantially increase the expense and red tape of filing a bankruptcy for the overwhelming majority who deserve relief and will net only a tiny number of abusers.

Page 504 PREV PAGE TOP OF DOC

The proponents of the bill keep saying only a small number of people will be disqualified by the means test. And you are saying the same, but you are saying that it will cause everybody a tremendous burden.

Then you say there may be some justification for imposing this bureaucratic and financial burden on some chapter 7 debtors, but is there much to be gained by so burdening those who have filed because of crushing medical debts or those who are struggling as single parents or those who are disabled or retired? A significant number of those over 5,000 chapter 7 debtors surveyed fell into each of these categories. The number of debtors with over $1,000 in medical debts is especially striking, particularly in rural areas.

Could you tell us roughly from your survey what percentage of people are we talking about who fall into these categories? What percentage of chapter 7 filers who have medical debts or are struggling as single parents, are disabled or retired?

Mr. **NEWSOME.** Well, first of all, Mr. Nadler, I have to make a disclaimer. Neither I nor my staff are statisticians, so I can only give you a rough basis for this.

Mr. **NADLER.** That is all I am asking.

Mr. **NEWSOME.** Let me just say, according to our figures, if you add up all the percentages—in other words, if you take—figure out what the percentage of people is or the percentage of cases that report a thousand dollars or more in medical debt and then you add up all of those percentages and you divide it by the number of districts, it comes out to 25 percent.

Page 505 PREV PAGE TOP OF DOC

That is not a weighted average. I don't want to mislead anybody. It is not a weighted average.

But when you go through the number of people—I was surprised, frankly, at the number of people who have over $1,000 in medical debt. Take a look at the district of South Dakota, for example. You are talking about 49 percent of the people in that district have over $1,000 in medical debt.

Take a look at all the districts in Tennessee. It is incredible the number of amount of medical debt they have got there.

Mr. **NADLER.** I am looking now at the Eastern District of Pennsylvania, where I just happen to fall on this. It says, the percentage of cases with medical debts over $1,000, 10 percent; percentage of single parents with custody, 21 percent; percentage of people disabled or retired, 11; and percentage of divorce filers 10 percent. So it is—10 and 11 is 21, 42, 52, 52 percent fall into one of those two categories in that district.

And your average for the country is 25 for medical debts over $1,000; single parents with custody, it is 12; and divorced filers, 15. For some reason you haven't given, it is blanked out the percentage of people disabled.

Mr. **NEWSOME.** Let me explain that. That is because we didn't do a percentage. We only did a raw number reported. There is no percentage. Even though it says it at the top of the column, we forget to take out percentage.

Page 506 PREV PAGE TOP OF DOC

Mr. **NADLER.** Between medical debts over a thousand, single parents with custody and divorce, you are talking 15, 40, 53 percent nationally.

Mr. **NEWSOME.** Some of them may fall into all of these categories.

Mr. **NADLER.** So 53 percent are in these categories where it is not likely to be abusive, where you can readily see the cause. Wouldn't you think it would make an improvement in the bill—not that it would make it acceptable—it would be an improvement in the bill if these categories of people just were categorically ruled out of the means test?

Mr. **NEWSOME.** I don't know. I don't know whether it would be an improvement or not. It might make it just more complicated, and it is complicated enough.

Mr. **NADLER.** You also say, as Exhibit 1 indicates, the medium amount of unsecured and unpriority debt for the 3,151 chapter 7 cases filed in 1998 is a staggering $23,411, with an overall median income of only $21,540. In other words, the average debt is greater than the average income.

Mr. **NEWSOME.** Median debt, that is the one right in the middle.

Mr. **NADLER.** Is greater than the median annual income?

Mr. **NEWSOME.** The average debt, by the way, is enormous. If you add up all the average debt of all of these people in all of the salaries, it is like $40,000 in unsecured debt, nonpriority debt. That is a fake number because some of them have $7 million in unsecured debt, for example.

Page 507 PREV PAGE TOP OF DOC

Mr. **NADLER.** Let me ask, Mr. Hildebrand, if I could, have any of your standing trustees calculated the increased cost of administration, and what would that increase costs due to creditor recoveries?

Mr. **HILDEBRAND.** Yes, sir, last year we made a survey of the trustees and determined that, with the tasks that were imposed on 13 trustees, that the system would be burdened with a cost of between 125 and 149 million dollars per year, that that cost——

Mr. **NADLER.** Let me stop you right there. 100—how much? 125 to 140?

Mr. **HILDEBRAND.** 125 to 149.

Mr. **NADLER.** Let us round up, 125 to $150 million. What is the cost of the system now?

Mr. **HILDEBRAND.** The cost of the system now—I have to do a little math here. It is approximately—about $180 million.

Mr. **NADLER.** So you are talking about roughly 60 to 75 percent increase in costs?

Mr. **HILDEBRAND.** Yes, sir. Now, to be fair, in the conference committee report two of the tasks that the trustees were reporting on were removed, so that number was based upon the original House bill.

Page 508 PREV PAGE TOP OF DOC

Mr. **NADLER.** That would be somewhat reduced?

Mr. **HILDEBRAND.** That would be somewhat reduced. There are, however, reduced compensating funds to the trustees as a result of what was included in the conference bill from the original House bill.

Mr. **NADLER.** That would, of course, reduce recoveries to the creditors, because it comes out of their——

Mr. **HILDEBRAND.** As a matter of fact, if a trustee is assessing a percentage in excess of 6 1/2 percent, and the statute allows 10, but if currently a trustee is charging 6 1/2 percent and more, we calculate they could not perform the functions that the code—that the amended law would require them to perform.

Mr. **NADLER.** At 6 1/2 percent?

Mr. **HILDEBRAND.** They couldn't—they wouldn't have enough to—10 is not enough for them.

Mr. **NADLER.** In other words, the statutory ceiling is too low?

Mr. **HILDEBRAND.** Yes.

Mr. **NADLER.** Let me ask one more question, a quick question. The panel this morning, the chairman was asking Mr. Klee a question, and he said that the marginal costs—I think what he was saying, I want you to comment on this, that the marginal costs, the incremental benefit of the means test, was very small. In other words, I think what he was saying, and correct me if I am wrong, is that, compared to what you would recover from the means test and from taking the comparatively small number of people that the means test would catch and throw out chapter 7 to chapter 13, the cost of administering that would make it prohibitive. Do you agree with that?

Page 509 PREV PAGE TOP OF DOC

Mr. **HILDEBRAND.** I agree with that in two respects. The first respect is that the costs that the system would have to bear, which should be litigation, as Judge Newsome has indicated, trustee expense, as Mr. Waldschmidt has indicated, would increase as a result of these issues. And I have outlined that in the appendix to my testimony.

But it also results in a shift of what I call voluntary repayers in chapter 13 out of chapter 13. So if you put that into the equation, we will see a number of people who would now choose to be in chapter 13, under the amended bill choose not to be in chapter 13, because there is no incentive for them to do that and, because they qualify, they are not forced by the means test into a 13, they choose a 7.

So all of those—and the numbers there, as you heard all of the testimony about how many people will be moved from 7 to 13, our expectation is that about 70 percent of the people who are currently in chapter 13 would be incented to move to chapter 7, and they would not be caught by the means test. They would not be forced into 13.

Mr. **NADLER.** Thank you.

Mr. **GEKAS.** The time of the gentleman's has expired, and the time for the entire panel has expired. We issue to you our usual thanks for witnesses such as you. And, as I have stated many times, your comments will be well considered in the final outcome of this issue. Thank you very much.

Mr. **GEKAS.** We now invite the final panel to approach the witness table.

Page 510 PREV PAGE TOP OF DOC

The final panel is made up of Professor Michael Staten——

Mr. **STATEN.** Staten.

Mr. **GEKAS.** [continuing]. Distinguished Professor of Management and the Director of the Credit Research Center at the McDonough School of Business at Georgetown University.

Professor Staten received his Ph.D. in economics from Purdue University in 1980. Is Purdue still in the final 16?

Mr. **STATEN.** Yes, they are.

Mr. **GEKAS.** Yes, that is what I thought. Taught at the University of Delaware from 1980 to '88, where he received the Outstanding Faculty Instructor Award in 1984. He became Director of the Credit Research Center in 1990, while he was located at Purdue University's Krannert Graduate School of Management. The Center and Dr. Staten moved to Georgetown University in the summer of 1997.

Since its founding in 1974, the Credit Research Center has built a national reputation as the only academic research center in the United States devoted to the study of consumer credit market economics. The Center's research product is used by regulatory agencies, legislatures, the credit industry, consumer groups and the court system. As Director of the Credit Research Center, Professor Staten has designed and conducted projects on a wide range of policy-oriented issues involving consumer credit markets.

Page 511 PREV PAGE TOP OF DOC

He serves on the board of trustees for the National Foundation for Consumer Credit, and is a trustee for the Consumer Credit Education Foundation of the American Financial Services Association.

Joining him is Professor Marianne B. Culhane, a Professor of Law at Creighton University School of Law, where she has been teaching a variety of commercial law subjects for 22 years.

Professor Culhane received her bachelor of arts cum laude from Carleton College in 1968 and thereafter received her juris doctor degree magna cum laude from the University of Iowa and was elected to the Order of the Coif.

Upon graduating she became a law clerk to the Honorable Donald Lay of the Eighth Circuit Court of Appeals.

Her most recent publication is entitled, "Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors."

With our first two guests is Lisa A. Ryu, a Staff Economist with the National Association of Federal Credit Unions, where she monitors economic conditions, forecasts economic trends and analyzes how these trends will affect credit unions.

Before joining NAFCU, Ms. Ryu was a Research Specialist at the Neighborhood Reinvestment Cooperation, a nonprofit organization that provides technical and financial assistance to various community revitalization organizations across the Nation.

Page 512 PREV PAGE TOP OF DOC

Ms. Ryu obtained her masters degree in economics from George Mason University and is currently a Ph.D. candidate at that institution.

Dr. Thomas Neubig, National Director of the Policy Economics and Quantitative Analysis at Ernst & Young. Dr. Neubig serves there as a consultant to numerous public and private clients on a broad range of subjects. These include tax and regulatory policy issues as well as risk management quantification.

Prior to joining Ernst & Young in 1994, Dr. Neubig was previously associated with Price Waterhouse, where he was the Director of Financial Sector Economics/Tax Economics Department.

Before coming to Price Waterhouse, Dr. Neubig was the Director and Chief Economist in the Office of Tax Analysis at the United States Treasury Department.

Dr. Neubig has testified before the House Ways and Means Committee as well as before several State legislatures. He has also served as an expert witness in several legal cases and has authored numerous articles on various aspects of economics.

Dr. Neubig holds a master of arts degree and Ph.D., both in economics from the University of Michigan. He received his BA cum laude from Kalamazoo College.

Richard M. Stana—Stana——

Page 513 PREV PAGE TOP OF DOC

Mr. **STANA.** Stana.

Mr. **GEKAS** [continuing]. Is the Associate Director of the Administration of Justice Division at the General Accounting Office. He has been with the General Accounting Office for more than 22 years. He has served in a number of capacities in the GAO's headquarters, field offices and overseas. Recently, he assisted a House subcommittee investigation into alleged misconduct and mismanagement at the Internal Revenue Service.

He has worked on a range of administration of justice issues, including money laundering, immigration, judicial branch administration, asset forfeiture, law enforcement and corrections.

He obtained both his bachelor's degree in economics and a master's degree in financial management from Kent State University.

The usual rendition of your written statements for the record will be accomplished without objection, and we will ask that you try to restrict your oral review to 5 minutes.

Mr. **GEKAS.** We will start off with Professor Staten.

STATEMENT OF MICHAEL E. STATEN, PROFESSOR AND DIRECTOR, CREDIT RESEARCH CENTER, MCDONOUGH SCHOOL OF BUSINESS, GEORGETOWN UNIVERSITY, WASHINGTON, DC

Page 514 PREV PAGE TOP OF DOC

Mr. **STATEN.** Good afternoon, Mr. Chairman and members of the subcommittee.

I have a little sense of deja vu in sitting with you here again today. It was almost exactly a year ago that we visited the same issue. I am certainly pleased to be invited back to discuss bankruptcy reform.

A year ago, as you recall, I discussed with you the results of our research on repayment capacity among debtors who file for bankruptcy. Since we completed our petitioner study in October of '97, two additional studies have addressed the same question. These results bear directly on the question of how the means-testing provision of H.R. 833 would impact debtors in a court system.

As we sit here today, we know a great deal about who would likely be impacted by a means-testing formula. The results of three independent studies over the past 2 years have built a substantial body of research from which you can draw a conclusion. In this panel you are going to hear directly from the authors of all three studies. Since you already heard the details of the CRC study from me last year, I would like to use my time today to offer an assessment of what we now know from the studies taken as a group.

First, let's be clear on some details. I think all three studies represent good-faith efforts on the part of the research teams to identify true ability to pay of debtors as they appear on the courthouse steps. The study with the most recent data was conducted by Ernst & Young using a nationally representative sample of 2,100 debtors who filed for chapter 7 during 1997. That study was commissioned by Visa and Mastercard.

Page 515 PREV PAGE TOP OF DOC

Our study at the Credit Research Center used a sample drawn from bankruptcy courts in 13 major U.S. cities and examined nearly 3,800 debtors who filed for bankruptcy in 1996. Our study was funded through a grant from Visa and Mastercard.

The Creighton University study used a sample of 1,000 chapter 7 debtors who filed in seven bankruptcy districts during 1995. Their study was funded by a grant from the American Bankruptcy Institute, and data collection was funded through an earlier grant from the National Council of Bankruptcy Judges and the Nebraska bar association.

Three studies, three different time periods, three different sets of districts sampled. Despite these differences, they collectively support the following five conclusions:

First, all three demonstrated that there are tens of thousands of households asking the courts for chapter 7 discharge who appear able to support a meaningful chapter 13 repayment plan. Using the estimates from the only study that supports national projections, we would conclude that up to 100,000 households who filed in 1998 would have been shifted to chapter 13 under H.R. 833.

Second, both the ABI and the Ernst & Young studies demonstrate that it is technically feasible to implement a means-testing formula.

Some witnesses last week, including Professor Elizabeth Warren, asserted that the means test in H.R. 833 would be impossible to administer. Obviously, that is not true. However, what is apparent in comparing the ABI and the Ernst & Young studies is that some of the legislative language may need clarification, given that the two research teams made different assumptions about items such as allowable transportation expenses and how to treat the trustees' fees in order to make their calculations.

Page 516 PREV PAGE TOP OF DOC

Third, means testing under H.R. 833 only impacts those bankrupt debtors in the upper half of the income distribution. For example, no petitioner with a family of four in 1997 would have been subject to the means test if their income was less than $53,000 a year. As my colleague from Ernst & Young will testify, over 80 percent of the chapter 7 filers in 1997 would have been exempt from means testing based on their income. They fall out very quickly and do not further burden the system.

Fourth, the study with the most recent data found the highest repayment capacity. Now, I can't tell you how much of this is due to the Creighton study having older data, and a less representative sample, versus differences in the assumptions that two research teams made in doing the repayment calculations. But I can tell you this. In 1995, the year of the Creighton sample, there were 875,000 personal bankruptcies in the U.S. In 1997, the year of the Ernst & Young sample, that number had grown by 54 percent to 1,350,000. Clearly, some change occurred in the factors that contribute to a bankruptcy decision during those 2 years.

Given this kind of growth, it is highly inappropriate to take the 1995 petition characteristics and assume they hold today.

Finally, as a resource for simulating the impact of changes in Federal bankruptcy policy, the Ernst & Young sample of debtors who filed in 1997 is the superior database. Neither the CRC nor the ABI/Creighton studies was designed to be nationally representative. In contrast, the Ernst & Young study was designed to address all the sampling issues that the GAO raised in its review of our own work a year ago.

Page 517 PREV PAGE TOP OF DOC

Those Members of Congress who spoke out strongly last year for a database suitable for guiding national policy now have one in the Ernst & Young database.

That concludes my statement. I would be happy to answer any questions.

Mr. **GEKAS.** We thank you, Professor.

[The prepared statement of Mr. Staten follows:]

PREPARED STATEMENT OF MICHAEL E. STATEN, PROFESSOR AND DIRECTOR, CREDIT RESEARCH CENTER, MCDONOUGH SCHOOL OF BUSINESS, GEORGETOWN UNIVERSITY, WASHINGTON, DC

SUMMARY

During the 1998 debate over bankruptcy reform, two studies (one conducted by the Credit Research Center at Georgetown University and the other by Ernst and Young, LLP) found that a sizeable minority of Chapter 7 debtors appeared able to fund meaningful Chapter 13 repayment plans. After the 105th Congress adjourned a third study conducted at Creighton University was released. All three studies are relevant to the debate regarding whether eligibility for a Chapter 7 discharge should be subject to a means-testing formula. This testimony offers an assessment of what we know from these studies taken as a group.

Despite differences in sampled courts, time periods and methods of calculating repayment potential, five key points emerge.

Page 518 PREV PAGE TOP OF DOC

1. All three studies demonstrate that there are thousands of households asking the courts for discharge under Chapter 7 who could support meaningful Chapter 13 repayment plans.

2. Both the ABI/Creighton and Ernst and Young studies demonstrate that it is technically feasible to implement a means-testing formula. However, differences in interpretation of the legislative language accounted for some of the differences between the two studies in their estimates of ability to repay.

3. Means-testing as proposed in H.R. 833 only impacts petitioners who are in the upper half of the U.S. income distribution for their given household size. The means test will not impact the poor (by definition), force impoverished debtors into repayment plans, or create a class of debtors "too rich for Chapter 7 and too poor for Chapter 13."

4. The fact that the study which sampled the most recent petitions (Ernst and Young) found the highest repayment

capacity raises the disturbing possibility that repayment capacity among Chapter 7 debtors may be growing with each passing year.

5. As a resource for simulating the impact of changes in federal bankruptcy policy, the Ernst and Young sample of Chapter 7 petitioners who filed in 1997 is the superior database.

I. INTRODUCTION

Good afternoon Mr. Chairman, and members of the Committee. My name is Michael Staten and I am a Professor of Management and Director of the Credit Research Center at the McDonough School of Business at Georgetown University. As you may know, over its 25-year history the Credit Research Center has generated over 100 research papers, most of which examine the impact of public policy toward consumer and mortgage credit markets. During the past quarter-century the Center's research program has been supported by a mix of grants and contracts from both the public sector (e.g., National Science Foundation; Federal Trade Commission) and private sector foundation and corporate grants.

Page 519 PREV PAGE TOP OF DOC

I'm pleased to be invited to join you again to discuss bankruptcy reform. As you may recall, I appeared before this committee in March, 1998 to share with you the results of our research on the repayment capacity of debtors who file for personal bankruptcy. Today I would like to re-visit the issue of repayment capacity as it is especially relevant to the means-testing mechanism that I believe is an integral component of serious bankruptcy reform. H.R. 833 proposes a similar mechanism to the need-based formula of its predecessor in the 105th Congress, H.R. 3150.

As we sit here today we know more about the likely impact of such a formula than we did a year ago. Three independent studies in the past two years have built a substantial body of research from which to draw conclusions about whether and how a means-test for Chapter 7 eligibility should be implemented. Two studies you heard about during last year's hearings. Late in 1998 a new study sponsored by the American Bankruptcy Institute was added to the literature on repayment ability. In this panel today you will hear directly about the ABI study from one of its authors. In my testimony I would like to offer an assessment of what we now know from these studies taken as a group.

II. THREE STUDIES OF REPAYMENT CAPACITY

During the 1998 debate over bankruptcy reform, two studies (one conducted by the Credit Research Center at Georgetown University and the other by Ernst and Young, LLP) were presented during Congressional hearings. Both studies were funded by Visa and MasterCard. Both found that a sizeable minority of Chapter 7 debtors appeared to have the economic capacity to repay a significant portion of their debts within a Chapter 13 repayment plan.

Page 520 PREV PAGE TOP OF DOC

The CRC study (John M. Barron and Michael E. Staten, "Personal Bankruptcy: A Report on Petitioners Ability to Pay," Credit Research Center Monograph #33, October, 1997) was conducted prior to the development of the needs-based formula in HR 3150 and so could not simulate its impact. Instead, we used the debtor's own statement of monthly living expenses and calculated the amount of debt repayable by 3,800 Chapter 7 debtors (regardless of income) in 13 U.S. cities within a five-year repayment plan. The result: about 25 percent of Chapter 7 debtors could have repaid at least 30 percent of their non-housing debts over a 5-year repayment plan, after accounting for monthly expenses and housing payments. About 5 percent of Chapter 7 filers appeared capable of repaying all of their non-housing debt over a 5-year plan. All calculations assumed income would remain unchanged relative to expenses over the five years. For a more detailed discussion of the CRC study, a subsequent review by the U.S. General Accounting Office (GAO), and our response, I refer you to my written testimony from one year ago (testimony by Michael Staten, "The Empirical Case for Needs-Based Bankruptcy," U.S. House of Representatives, Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, March 12, 1998).

The Ernst and Young study ("Chapter 7 Bankruptcy Petitioners' Ability to Repay: the National Perspective, 1997", T. Neubig, F. Scheuren, G.Jaggi and R. Lee, March, 1998) was specifically designed to simulate the impact of H.R. 3150 with a sample that met the GAO's statistical criteria for a nationally representative sample. Using a sample of over 2,100 Chapter 7 bankruptcy petitions filed in 90 bankruptcy districts, the Ernst and Young researchers simulated the impact of the needs-based formula in H.R. 3150. They found that about 15% of Chapter 7 debtors in 1997 would have been shifted to Chapter 13 based on the formula in the February, 1998 version of H.R. 3150. The results of these two studies were cited by both Republicans and Democrats as reason to establish a needs-based approach to determining who qualifies for bankruptcy relief.

Page 521 PREV PAGE TOP OF DOC

After the 105th Congress adjourned, the results of a third study of repayment capacity were released in December, 1998. This latest effort to measure whether Chapter 7 debtors can actually repay their debts was funded by the American Bankruptcy Institute (data collection was funded by the National Council of Bankruptcy Judges). Authors Marianne Culhane and Michaela White, law professors at Creighton University, applied their interpretation of the means-testing formula from last year's HR 3150 to a sample of Chapter 7 petitioners who filed in 1995. Their goal was to determine how many would qualify for Chapter 13 repayment plans. Their conclusion: 3 percent of Chapter 7 debtors in their sample would have been shifted to Chapter 13 had H.R. 3150 been in effect in 1995. The remaining 97 percent of the Chapter 7 debtors in their sample either had incomes below the minimum required by H.R.3150, or had too little income after subtracting monthly expenses and various secured and priority debt payments to repay at least 20 percent of their unsecured debts over five years.

III. WHAT HAVE WE LEARNED?

What have we learned from these three separate and independent studies of repayment capacity among debtors using the bankruptcy courts? Despite differences in sampled courts, time periods and methods of calculating repayment potential five key points emerge.

1. All three studies demonstrate that there are thousands of households asking the courts for discharge under Chapter 7 who could support meaningful Chapter 13 repayment plans.

The lowest of the estimates (Creighton/ABI), if applied to 1998 filing volumes, indicates that over 30,000 households who filed for a Chapter 7 discharge actually had incomes that were above the national median and were also sufficient to support meaningful Chapter 13 repayment plans. Keep in mind that in its proposed legislation, Congress has defined a meaningful repayment plan to be one in which the debtor maintains payments on all secured debts (home mortgage, auto loans, etc) for up to five years, and also makes a significant payment to unsecured creditors. The Ernst and Young study presented to Congress (March, 1998) indicates that the number of Chapter 7s who should be in Chapter 13 ranges from 100,000 to 150,000 households (10–15% of Chapter 7 petitioners), depending upon whether the legislation sets the minimum income hurdle at 75% or 100% of the national median. *Clearly, the fact that tens of thousands of debtors are able to file for more bankruptcy relief than they need is now well established.*

Page 522 PREV PAGE TOP OF DOC

2. Both the ABI/Creighton and Ernst and Young studies demonstrate that it is technically feasible to implement a means-testing formula.

Some critics have complained that means-testing is an abstract and impractical concept that would impose too much complexity on judges and attorneys. In the hearing before this committee on March 11, 1999 Harvard Professor Elizabeth Warren asserted that the means test proposed in H.R. 833 "is impossible to administer." Yet, in the ABI/Creighton study, two law professors applied the exact criteria of the means-testing formula in last year's H.R. 3150, made several clarifying assumptions, and were able to classify debtors with the information supplied on the petition. The research team at Ernst and Young did the same thing with an earlier version of the means-testing formula.

A useful outcome of having two independent simulations of the means-testing formula is that Congress can now see where the formula criteria need to be clarified. Indeed, the assumptions that each research team adopted in making the calculations are responsible for at least some of the differences in their estimates of the size of the groups affected by the test. Based on information provided in the ABI/Creighton press release ("Means Testing For Chapter 7 Debtors: Repayment Capacity Untapped? December, 1998) there appear to be three significant areas where the procedures used to calculate repayment capacity differ from the assumptions used by the Ernst and Young researchers.

A. *Minimum income.* Because it was conducted early in the legislative development of H.R. 3150, the Ernst and Young study incorporates a restriction that petitioners must have an income greater than 75 percent of the national median (adjusted for family size) to be subject to the means-testing formula. The ABI/Creighton study simulates a later version of H.R. 3150 that raises the income required for means-testing to 100 percent of the national median. The higher income requirement exempts more debtors from means testing, so fewer are impacted.

Page 523 PREV PAGE TOP OF DOC

B. *Trustees' Fees.* The ABI/Creighton researchers assumed H.R.3150 intended the court to treat the Chapter 13 trustee's administrative fee as a monthly expense and subtracted it from the debtor's income *prior to computing eligibility for a plan.* Accordingly, they assumed an administrative fee equal to 5.6 percent of each monthly debt payment and subtracted this as a monthly expense. In fact, H.R. 3150 did not specify how trustee fees were to be handled, and such fees were not incorporated into the Ernst and Young calculations. It does make a difference. Debtors who are "close" to the eligibility cutoff but who do not qualify for a Chapter 13 plan under the ABI/Creighton treatment receive a Chapter 7 discharge and, presumably, pay little or nothing to unsecured creditors. If the trustee's fee was not incorporated into the means test but subtracted from actual debt payments, those same debtors would be placed in Chapter 13 plans and make payments to their creditors, minus a 5–6% fee to the trustee.

C. *Automobile Expenses.* The two studies sharply disagree on the proper treatment of automobile expenses in order to determine a debtor's allowance for living expenses. Their different interpretations of what is permissible under the IRS Collection Standards appears to account for as much as $200–300 per month in allowable expenses for many debtors. The ABI/Creighton study gives debtors a larger allowance, thereby lowering the percent of debtors who would qualify for Chapter 13 repayment plans.

Clarification of these elements of the means-testing formula within H.R. 833 would remove the technical obstacles to steering petitioners into the proper bankruptcy chapter. A needs-based formula that utilizes well-defined criteria to clearly signal how the court will treat a given debtor would streamline the administration of the system, promote consistent treatment and reduce costly litigation.

Page 524 PREV PAGE TOP OF DOC

3. Means-testing as proposed in H.R. 833 only impacts those bankrupt petitioners in the upper half of the income distribution.

Actually, we didn't need three studies to tell us this. The formula itself dictates this result, since the needs-based test applies only to households at or above the national *median* income, adjusted for family size. To illustrate, the national median income for a family of four in 1997 was $53,165. No petitioner in a family of four with an income less than $53,165 that year would have been subject to the means test. Still, opponents of means-testing continue to cite the low *mean* after-tax income of Chapter 7 petitioners (about $19,620 for the CRC sample in 1996) as evidence that H.R. 833 (and H.R. 3150 before it) would somehow force impoverished debtors into repayment plans. In her testimony last week, Professor Elizabeth Warren said "bankruptcy law is the last safety net of the middle class . . . Bankruptcy is the last hope for the small businessman, the divorced woman, the African-American homeowner, the displaced executive, and the elderly couple facing a sharp slide out of the middle class into the lower class." True enough, and there is nothing in the means-testing formula that weakens the safety net for those who truly need it.

4. The fact that the study which sampled the most recent petitions (Ernst and Young) found a higher repayment potential raises the disturbing possibility that the repayment capacity among Chapter 7 debtors may be growing with each passing year.

The ABI/Creighton study was based on petitions filed in 1995, but the Ernst and Young study analyzed petitions filed in 1997. This key point significantly affects the interpretation of the results. We know that 875,000 personal bankruptcy petitions were filed during 1995. We also know that filings soared over the next two years to reach a total of 1,350,000 in 1997, an increase of 54 percent. Some fundamental change in the factors that contribute to a bankruptcy decision clearly occurred during the intervening period to trigger such a dramatic increase. Under these conditions, it is inappropriate to extrapolate the results from a study of petitioners in 1995 and assume they describe petitioners filing in 1997–98.

Page 525 PREV PAGE TOP OF DOC

Indeed, the fact that the Creighton study found that only 3% of debtors in 1995 would be impacted by H.R. 3150 in no way precludes a larger percent of debtors being impacted by 1997. Given the remarkable escalation in petitions over the same time period, and under stellar economic conditions, one explanation for the greater repayment capacity found by Ernst and Young could certainly be that a *declining stigma to filing for bankruptcy has encouraged a growing proportion of debtors to opt for the Chapter 7 discharge*, despite having significant capacity to repay their debts. This alarming possibility reinforces the need for Congress to develop a workable means testing formula that will make bankruptcy relief available only to those who truly need it.

5. As a resource for simulating the impact of changes in federal bankruptcy policy, the Ernst and Young sample of Chapter 7 petitioners who filed in 1997 is the superior database.

Both the CRC and ABI/Creighton studies sampled from a relatively small number of bankruptcy districts (13 and 7, respectively, out of 90 in the continental U.S.). Neither study was designed to be nationally representative. In contrast, the Ernst and Young researchers designed their study to address every sampling criticism that the GAO raised in its review of the CRC study. Those members of Congress who spoke out strongly last year for a database suitable for guiding national policy now have one in the Ernst and Young database.

Thank you for the opportunity to appear before the committee today. I will be happy to answer any questions.

Mr. **GEKAS.** We turn to your colleague, Professor Culhane.

Page 526 PREV PAGE TOP OF DOC

STATEMENT OF MARIANNE B. CULHANE, PROFESSOR, CREIGHTON UNIVERSITY SCHOOL OF LAW, OMAHA, NE

Ms. **CULHANE.** Mr. Chairman, members of the subcommittee, I am honored to be here this St. Patrick's Day.

As, Mr. Chairman, you noted in my introduction, with another good Irish woman, Professor White, and funding from Creighton Law School and the American Bankruptcy Institute, I have completed a test drive of sorts. We took means testing on the road, put it through its paces to see if it would work as advertised on a random sample of more than a thousand real chapter 7 cases. The full report of that test drive will appear in the next issue of the American Bankruptcy Law Review and has been inserted in the record of this hearing.

What did we find? First, that only 3.6 percent of all chapter 7 cases in our sample emerged as "can pays" who would be dismissible from chapter 7. We were following H.R. 3150's version of means testing, so there might be some slight change with the current bill. But over 96 percent would have remained eligible for chapter 7.

Second, even the 3.6 percent is too high, because many of them could have, had they been filing under a means-testing system, taken a detour. They could use the tithing bill that was passed just last year.

We checked, once we had figured out who the probable "can pays" were, what would have been the outcome if they had chosen to give 15 percent of their gross income to a church or a charity. That left five people out of the 1,041 who were still able to pay 20 percent of their debts. And, presumably, one would not have to make the 15 percent for all of the 5 years. One would have to start maybe a few months before bankruptcy and make it until a decision to keep you in chapter 7 had passed or maybe for another year until it was too late to revoke your discharge for fraud. Similarly, one can purchase a car or otherwise increase secured debt prior to bankruptcy.

Page 527 PREV PAGE TOP OF DOC

Either of these routes, increasing secured debt or increasing donations, could be used and would be used by well-counseled debtors to detour around means testing.

Third, even assuming very little of this detouring, the bottom line is far below Visa's promised $4 billion a year pot of gold. If 3.6 percent of 1997's cases were identified as "can pays" and could repay 75 percent, let's say, of their median unsecured debt, that would be about $870 million. That is not even $1 billion and far below $4 billion.

But even that $870 billion is based on an impossible dream, a faulty assumption that the General Accounting Office and others have criticized so justly in the Visa studies.

That assumption is that for the next 5 years income of these debtors will rise as fast as expenses and debts. Now let's look at that impossible dream. Will income rise as fast as expenses and debts for 5 years?

Dr. Staten's own study, as I recall, found that 70 percent of his chapter 7 debtors had a major income drop in the single year before they filed. How will bankruptcy make them immune for the next 5 years?

Over 5 years some will die, and I have heard that has a bad impact on income. The rest will get 5 years older. Some will suffer disease, divorce, disability, downsizing. Nothing about bankruptcy prevents these all too human ills. Some are small business owners. Some will fail. Sure, a few debtors may win the lottery, but more will become or remain problem gamblers. Even delightful events like new babies, and over 5 years there will be new babies, entail years of increased expenses and eventually those nondischargeable student loans. None of these events is stopped by the stay.

Page 528 PREV PAGE TOP OF DOC

Can you trust these numbers? After all, who are Marianne Culhane and Michaela White? Why should you believe us? You will soon have a neutral expert opinion from the GAO. We are releasing all of our data to the GAO. That is a step Visa would not let its researchers take.

Let's turn to some points raised by Ms. Ryu of the National Association of Credit Unions. She says that our first short report last December was terribly biased and our numbers would be much greater if we weighted our sample to reflect proportional filings by district. She is right, we should have weighted it. We have done so. The numbers have risen all the way to 3.55 percent from 3.45, one-tenth of 1 percent.

Next, Ms. Ryu has claimed that too many of our seven districts are low income. Sorry, I think that is just not true. The Northern District of California is the San Francisco Bay area, second only to Honolulu in cost of living. Massachusetts Bay area and Colorado, Ms. Ryu's own figures show those as high income. Middle District of North Carolina, that is the Raleigh-Durham Research Triangle. Madison, Wisconsin, that is high. What we have here is a Lake Woebegone sample. Only Nebraska, where I live, is a low income district. Almost all of our districts are above average in income.

Ms. Ryu says we were wrong to treat chapter 13 trustees' fees, and debtors' attorneys' fees as priority claims. After all, the Visa studies ignored these costs. These are real costs. They are priority claims today and would be under H.R. 833. Congress of course may sort debtors any way it wants. It can set up the "can't pay" categories any way it pleases. It can ignore or include these real costs at the front end for means testing, but they are real costs. They will reduce payouts to creditors. If we are trying to decide who can repay and how much, let's include the real costs.

Page 529 PREV PAGE TOP OF DOC

Next Ms. Ryu disputes our treatment of motor vehicle expenses. Well, the bill said use the IRS CFS allowance. We did. Ernst & Young didn't allow any debtor to use the IRS motor vehicle allowance, ownership allowance, which covers leasing costs, major repairs and replacement costs. They say if you owe some motor vehicle debt when you file, you can repay that, but that is all for 5 years. If you lease, tough, no allowance for that cost. Give the car back, I guess. If the car is old and the transmission dies in 5 years, too bad. If the car is stolen or totaled or just quits, tough, walk or take the bus, if there is one; and by the way, that is your pregnant wife and 10-year-old daughter, too, for 5 years.

Mr. **GEKAS.** Would you come to a conclusion?

Ms. **CULHANE.** We are trying to predict how much debtors can repay realistically for 5 years into the future. If the debtor can't get to work because she has lost their transportation, the debtor can't earn income to repay anyone. Yet the means-testing figures of the creditors' study assumes no loss of income for 5 years, no replacement of worn-out, totaled motor vehicles, no leasing costs.

Well, the test drive of means testing seems to show that yes, it isn't going to catch very many debtors, but that doesn't mean that it doesn't impact lots of debtors. Other speakers have pointed out the substantial burdens of paperwork and delay that other provisions of the bill impose in order to do the sorting that is necessary for means testing.

Thank you, Mr. Chairman.

Page 530 PREV PAGE TOP OF DOC

[The prepared statement of Ms. Culhane follows:]

PREPARED STATEMENT OF MARIANNE B. CULHANE AND MICHAELA M. WHITE,(see footnote 28) Professors, Creighton University School of Law, Omaha, NE

TAKING THE NEW CONSUMER BANKRUPTCY MODEL FOR A TEST DRIVE: MEANS-TESTING REAL CHAPTER 7 DEBTORS

INTRODUCTION

The continued climb in personal bankruptcy filings in the late 1990's, a time of general prosperity and low unemployment, has convinced some that debtors are abusing the system, taking an "easy out" when they could, with effort, repay much of their unsecured debt. Access to Chapter 7's fresh start, it is urged, should be restricted. Others argue that most Chapter 7 filers are more burdened by debt than ever, and that major consumer creditors, especially credit card issuers, are hardly blameless victims.(see footnote 29) Some holders of this view would let the market punish irresponsibility in both camps, imposing losses on lenders and reducing credit to debtors.

The debate on bankruptcy abuse has been accompanied by bankruptcy reform bills in both houses of Congress. Several of these bills include means-testing for Chapter 7 debtors,(see footnote 30) a concept long advanced by the consumer credit industry.(see footnote 31) Means-testing would first, develop a mathematical model to predict which Chapter 7 debtors have substantial ability to repay unsecured debt; and second, require those "can-pay debtors"(see footnote 32) either to repay in Chapter 13 over five to seven years, or to forego a discharge.(see footnote 33) Means-testing would deny such debtors the relatively quick Chapter 7 fresh start, which does not require use of post-petition income to repay most debts.(see footnote 34) Some models of means-testing would reduce the discretion bankruptcy judges now have under section 707(b) to dismiss consumer Chapter 7 cases for "substantial abuse."(see footnote 35)

Page 531 PREV PAGE TOP OF DOC

For arguments in favor of means-testing, *see* Hon. Edith H. Jones & Comm'r James I. Shepard, Additional Dissent to Recommendations for Reform of Consumer Bankruptcy in Nat'l Bankr. Rev. Comm'n, Bankruptcy: The Next Twenty Years, Final Report Ch. 5, at 10–27 [hereinafter Jones-Shepard Dissent and Commission Report] (discussing means testing bankruptcy). Judge Jones and Professor Todd Zywicki are preparing an article for the January 1999 edition of B.Y.U. L. Rev. as well, tentatively titled "It's Time for Means-Testing."

VISA/U.S.A. Inc., a preeminent unsecured creditor and vigorous advocate of means-testing, has commissioned a series of empirical studies of the repayment capacity of Chapter 7 debtors.(see footnote 36) The most recent of these, by the accounting firm of Ernst & Young in March, 1998,(see footnote 37) followed the means-testing formula of H.R. 3150, the bill which appeared to have the greatest prospect for passage in the 105th Congress.(see footnote 38) Ernst & Young initially concluded that 15% of a national proportional sample of 2,200 Chapter 7 filers were "can-pays" under that bill. They further asserted that H.R. 3150's means-testing would have allowed unsecured creditors, on a national basis, to collect $4 billion more than did the current system.(see footnote 39) Ernst & Young later reduced the can-pay estimate to 11%, after H.R. 3150 was amended.(see footnote 40) However, to our knowledge, they did not publicly announce any reduction in the projected $4 billion net gain.

The VISA-funded studies were much criticized by academics(see footnote 41) as well as by the General Accounting Office (GAO). The GAO's chief criticisms were that these studies ignored Chapter 13 administrative expenses and based their projections on two unrealistic assumptions: first, that for the next five years, each affected debtor's income would rise as quickly as debts and expenses; and second, that 100% of these debtors would complete a 60-month Chapter 13 plan. The GAO noted that current voluntary Chapter 13 plans have only a 30% completion rate.(see footnote 42)

Page 532 PREV PAGE TOP OF DOC

It appeared to us that one more study was needed, one not funded or controlled by creditors with a financial stake in the outcome. In late 1997, we applied for a grant from the non-profit American Bankruptcy Institute's (ABI) Endowment to support an empirical investigation of means-testing; a test drive of this new model of consumer bankruptcy. We had in hand a ready-made database of over 1,000 individual Chapter 7 cases, from seven judicial districts in seven federal circuits across the nation. These had been collected for use in an ongoing study of reaffirmation practices, funded by the National Conference of Bankruptcy Judges.(see footnote 43)

Debt and income data from the Reaffirmation Project were shared with Professor Elizabeth Warren and appear in her article, *The Bankruptcy Crisis*, *supra* note 1 at 1103–1110. The income data supplied to Professor Warren were net of all payroll deductions. However, the income figures used for this means-testing study are gross figures.

In April, 1998, the ABI agreed to fund the project. In light of pending legislation and the release of Ernst & Young's March, 1998 report, we decided to apply the version of means-testing in H.R. 3150 passed by the House of Representatives in June, 1998.(see footnote 44) We also decided to follow many of the steps used by Ernst & Young to facilitate comparison of results.

This article records our results, as well as how and why they might differ from Ernst & Young's. It also sets out insights gained from our test drive of means-testing. Part I is a short summary of means-testing and our conclusions. Part II covers the mechanics of means-testing: steps required, assumptions made and results obtained. Part III projects our sample's repayment capacity to the national level and examines the "impossible dreams" on which VISA's five-year estimates have been based. Appendix A contains short profiles of the can-pay debtors whom H.R. 3150 would dismiss from Chapter 7. Appendix B describes our sample design, data collection and coding.

Page 533 PREV PAGE TOP OF DOC

PART I—OUR RESULTS, ERNST & YOUNG'S RESULTS AND WHY THE TWAIN DON'T MEET.

Our test drive has led us to the following conclusions:

First, abuse of Chapter 7, in the form of filings by debtors who could repay under H.R. 3150's formula, appears minimal. Only 3.6% of sample debtors emerged as apparent can-pays. Ninety-six and four-tenths percent of the sample debtors were rightly in Chapter 7.(see footnote 45)

In an earlier paper on this project, we reported a total of 35 can-pay debtors using a sample of 1,043 Chapter 7 cases. Further analysis has turned up two more. We have also excluded two cases from the sample of 1,043 because the debtors in those two cases did not file Schedule I (Income). Thus, the final sample for the Means-Testing Project is 1,041. *See* Marianne Culhane & Michaela White, Means-Testing for Chapter 7 Debtors: Repayment Capacity Untapped? <http://www.abiworld.org/research/creightonstudy.html>

Second, sophisticated debtors could avoid can-pay status by taking on more debt or increasing charitable contributions. The 3.6% could drop once debtors adjusted to the new rules.

Third, even under the overly optimistic assumptions of the VISA studies, H.R. 3150 would allow nonpriority unsecured creditors to collect at most an additional $930 million from can-pay debtors across the nation. If our sample results held for the nation as a whole, a more realistic estimate would be $450 million, less than one-eighth of VISA's estimate.

Page 534 PREV PAGE TOP OF DOC

Fourth, in operation, the necessary analysis will be costly and labor-intensive when applied to a million or more Chapter 7 cases a year. In addition to median income testing of all cases, H.R. 3150 required additional individualized scrutiny of 24% of sample Chapter 7 filings (33% in some districts) to find the 3.6% who emerged as apparent can-pays.

We did not attempt to assess the cost to taxpayers of H.R. 3150's means-testing. The Congressional Budget Office (CBO), however, estimated that H.R. 3150's provisions as a whole would have cost $214 million in the first five years, plus another $8–16 million for additional judges needed for means-testing.(see footnote 46)

All the empirical studies to date agree on one point; the vast majority of Chapter 7 debtors belong in that chapter. They have too little income after necessary expenses to repay unsecured debt. It is vital, therefore, that no undue burdens be thrust on that needy majority in order to flush out a small minority of abusers.

Overview of Means-Testing Under H.R. 3150.

H.R. 3150's version of means-testing asks three questions about each individual or joint Chapter 7 case. In greatly simplified form, those three questions are:

1) Is debtor's annual gross income at least equal to the national median income for households of like size?

Page 535 PREV PAGE TOP OF DOC

2) Would debtor have more than $50 of remaining income each month after living expenses and payments on secured and priority debt?

3) If debtor's remaining monthly income were applied to nonpriority unsecured debt for the next five years, would it

repay at least 20% of that debt?(see footnote 47)

(h)(1) An individual or, in a joint case, an individual and such individual's spouse, have income available to pay creditors if the individual, or, in a joint case, the individual and the individual's spouse combined, as of the date of the order for relief, have—
(A) current monthly total income of not less than the highest national median family income reported for a family of equal or lesser size or, in the case of a household of 1 person, of not less than the national median household income for 1 earner, as of the date of the order for relief;
(B) projected monthly net income greater than $50; and
(C) projected monthly net income sufficient to repay twenty percent or more of unsecured nonpriority claims during a five-year repayment plan.

H.R. 3150 §101(4).

If the answer to all three questions is yes, that debtor is a can-pay, ineligible for Chapter 7. On the other hand, if the answer to any of the questions is "No," then H.R. 3150 treats the debtor as a can't-pay, rightfully in Chapter 7.

Page 536 PREV PAGE TOP OF DOC

Our results for each question are displayed in the chart below.(see footnote 48)

63593x.eps

Table 1 sets forth the results of H.R. 3150's three tests for each of the sample districts.

Table 2

We conclude that only 3.6%(see footnote 49) of our sample are can-pays under H.R. 3150. Ernst & Young put 11% of their sample into the can-pay category.(see footnote 50) Both studies assumed, unrealistically, no avoidance behavior by debtors likely to be impacted. If many debtors chose to increase debt or charitable contributions, these percentages would fall. This dramatic difference is due to a variety of factors. First, we interpreted the bill's car ownership expense allowance more broadly than did Ernst & Young. Ernst & Young allowed debt retirement only, while we added major repairs, replacement and leasing costs. Second, we estimated Chapter 13 administrative expenses and deducted these priority claims from amounts available to creditors. Ernst & Young, like earlier creditor studies, ignored these real world costs.(see footnote 51) Third, we charged interest on secured claims for five years rather than just two years. Fourth, the reports are based on samples of different designs.(see footnote 52) Fifth, our sample was drawn from 1995 filings, while Ernst & Young's sample was drawn from 1997 filings.

PART II—APPLYING H.R. 3150'S MEANS-TESTING FORMULA TO THE SAMPLE

Page 537 PREV PAGE TOP OF DOC

A. The Median Income Test.

H.R. 3150 uses an income test to make its first cut. If required proof of income is not unduly burdensome, an income test might serve reasonably well.(see footnote 53) Any means-testing system needs a mechanism that quickly, inexpensively and predictably eliminates all but the most likely candidates for can-pay status, freeing the can't-pay majority of debtors to make a fresh start. Such a front-end screen will reduce the cost and increase the efficiency of means-testing. Using a median income test at the front end to free most debtors to continue in Chapter 7 is far better than the approach taken in the Conference version of H.R. 3150, recently resurrected as the Bankruptcy Reform Act of 1999 in the 106th Congress. In these bills, all Chapter 7 cases are put through the complex Projected Monthly Net

Income Test, which requires rigorous examination of individual debts and expenses. A median income test is used only at the end of the process, to determine whether creditors, in addition to judges and trustees, can move to dismiss the Chapter 7 case.(see footnote 54)

Current Annual Gross Income and Household Size. H.R. 3150 compares the debtor's annual gross income to national median incomes. The test is relatively simple; the only data needed from the debtor are annual gross income and household size. The bill calculates annual gross income by first, determining the debtor's average *monthly* gross income for the six months preceding the petition; and second, multiplying that figure by 12 to come up with the figure to be compared with the relevant median.(see footnote 55) Since the necessary data for that calculation are not supplied by the current Official Bankruptcy Forms, we, like Ernst & Young, substituted the debtor's current monthly gross income from Schedule I and multiplied it by 12.(see footnote 56) Both studies determined household size by adding two to the number of dependents in joint cases and one to the number of dependents in individual cases.(see footnote 57)

Page 538 PREV PAGE TOP OF DOC

In joint cases, both spouses' gross incomes are aggregated. When a married debtor files an individual rather than a joint petition, H.R. 3150 would sometimes mandate inclusion of the non-filing spouse's income in means-testing. H.R. 3150 §101(1)(A). However, disclosure of spousal income in such cases is not currently required, so it could not be included here. Thus, gross income in such cases may be understated. In our sample, 9.7% of the cases involved married debtors filing individually. E & Y did not disclose the portion of its sample so filing.

National Median Incomes. The bill requires use of the most recent prior year's medians available from the Census Bureau as of January 1st of the year in which the petition was filed.(see footnote 58) Because our cases were filed in 1995, we used 1993 medians:

one person(see footnote 59)

Ernst and Young's March, 1998 written analysis apparently used the lower median income figure for "households of one" as well as 75% rather than 100% of the relevant median incomes. They later applied 100% of the median to their sample and found that 11% were can-pays. *See supra* note 12. We do not know whether they continued applying at 100% the lower median income figure for "households of one" rather than the higher median for "households with one earner."

$25,560

Page 539 PREV PAGE TOP OF DOC

two persons

31,302

three persons

38,727

four or more persons(see footnote 60)

45,161

Our Median Income Test Results. As Table 2 shows, 24% of our weighted sample(see footnote 61) had incomes at or above the national medians. These results are not directly comparable to Ernst & Young's, for they followed an earlier version of H.R. 3150 which set the cut at 75% rather than 100% of the medians.(see footnote 62) Forty-seven percent of their sample had incomes meeting that lower threshold.(see footnote 63)

We display our results for H.R. 3150's three tests in Tables 2, 4 and 5. Each table shows both the number of sample cases which passed the test, and a pass rate weighted by the actual number of nonbusiness Chapter 7 cases filed in 1995 in each of our seven sample districts. To weight those results, we followed these steps:

Page 540 PREV PAGE TOP OF DOC

1) Computed district pass rates by dividing the number of sample cases from a district which passed the relevant test ("# Passed") by the total number of sample cases from that district ("Sample"). District pass rates are displayed as "% Passed."
2) Estimated the total number of cases from each district which would have passed the relevant test, by multiplying the actual number of non-business Chapter 7 cases filed in each district in 1995 ("Total Ch. 7 Filings in 95") by the district's pass rate ("% Passed). The result is displayed as "Estimated # Passed."
3) Summed the results of Step 2 for an estimated total number of cases from all seven districts which would have passed the relevant test. That total appears at the base of the "Estimated # Passed" column.
4) Computed the overall weighted pass rate by dividing total "Estimated # Passed" by the total number of cases filed in 1995 in all seven districts (54,802 cases). The result is displayed as "Weighted Pass Rate" at the bottom of the table for each test.

Table 3

Weighted pass rate = 24.2%(see footnote 64)

While the majority of cases in our sample and Ernst & Young's had incomes below 75% of the medians, almost one-fourth of our sample had incomes at or above the national medians. This may seem surprising, but one should keep in mind two factors raising the numbers. First, both samples include not just wage-earners and pensioners, but also debtors who are self-employed in whole or part. Gross income for the self-employed means gross revenues from their business, before deduction of ordinary and necessary business expenses. Only after deduction of those expenses is their income comparable to that of wage-earners, because only the adjusted income is available for living expenses and debt repayment. Thus, the higher gross incomes of some self-employed debtors do not necessarily indicate greater capacity to repay.

Page 541 PREV PAGE TOP OF DOC

A second and more pervasive influence is the use of national medians. Debtors from relatively high cost-of-living areas, such as San Francisco and Boston, are much more likely than Nebraskans or Georgians to have incomes at or above national medians, even though their higher expenses may mean San Franciscans and Bostonians are no more likely to emerge as can-pays after all three tests are done. Use of national medians works both ways, cutting out some debtors in low cost-of-living areas with incomes below national medians, who may nevertheless have repayment capacity. But the overall impact of national medians on our sample, when weighted by cases filed per district, is to increase the percentage with incomes at or above the medians. This occurs because many more Chapter 7 cases were filed in 1995 in the Northern District of California, the District of Massachusetts and the District of Colorado, some of the higher cost-of-living parts of our sample, than in the Northern District of Georgia, the District of Nebraska, the Middle District of North Carolina, and the Western District of Wisconsin.(see footnote 65)

We find the median income test to be more efficient at 100% rather than 75% of the relevant median. No doubt, there are debtors with incomes below the 100% level who currently have repayment capacity. However, they will be scarcer than at 100%, so more cases would have to be tested (and more deserved fresh starts delayed) to find each additional can-pay. Further, debtors with lower incomes are less likely to complete a 60-month plan returning any substantial amount to unsecured creditors. Setting the cut at 100% of the median will better balance the need for a quick and efficient cutoff of all but the most likely can-pays against the desire to capture the real can-pays.

We also recommend increasing the cutoff level for larger families. As noted above, H.R. 3150 applies the family of four median to all families of four or more persons.(see footnote 66) Our sample included 106 cases filed by debtors with families of five or more persons. Twenty-two of these cases passed the median income test, but only one emerged as a can-pay. Thus, the family of four median required individualized scrutiny of 11 large-family cases to locate one can-pay case. A substantial increase in the minimum income figure for families of five or more would increase efficiency.

Page 542 PREV PAGE TOP OF DOC

In sum, H.R. 3150's median income test is not as efficient a front-end screen as it could be. The test will require considerable stream-lining if it is to fulfill its function of identifying only the likely can-pays.

B. The $50 a Month Test (Projected Monthly Net Income Test).

The second stage of means-testing under H.R. 3150 is the Projected Monthly Net Income Test. This test is much more complex than the first, requiring detailed scrutiny of each debtor's debts and expenses. The test asks whether the debtor would have more than $50 of remaining income each month after living expenses and payments on secured and priority debt. If so, the debtor is a potential can-pay who must proceed to the third and final test. If not, the debtor is rightfully in Chapter 7. In essence, the bill presumes for purposes of means-testing that for five years the debtor will enjoy a stable income, keep expenses within an IRS budget, retain all collateral, repay 100% of non-real estate secured and priority debt in 60 equal installments and continue regular payments under the original contract on long-term real estate debt.

The No Cram-Down Rule. Anyone familiar with Chapter 13 may ask, "Why assume 100% payment of non-housing secured debt?" After all, current practice is to bifurcate or "cram down" secured claims to the value of the collateral, and treat the balance of the debt in law as it is in fact, unsecured.(see footnote 67) "Cram down" is one of the principal inducements to debtors to file in Chapter 13.(see footnote 68)

Page 543 PREV PAGE TOP OF DOC

(B) the average monthly payment on account of secured creditors, which shall be calculated as the total of all amounts scheduled as contractually payable to secured creditors in each month of the 60 months following the date of the petition.

H.R. 3150 §101(3)(B), 105th Cong. (1998).

However, the no-cram-down assumption for means-testing reflects another of H.R. 3150's proposed changes to consumer bankruptcy. One version of the bill would amend Code section 506 to prohibit cram down on purchase-money claims for "personal property acquired by the debtor within five years of the filing of the petition."(see footnote 69) Instead, the value of the collateral and the allowed secured claim equal "the sum of the unpaid principal balance . . . and . . . interest and charges at the contract rate."(see footnote 70) Is the no-cram-down provision a payoff to car and furniture lenders for not opposing means-testing?

Imagine the glee of the car financiers when . . . [the bill] fixed the value of five year old used cars . . . at the amount due under the contract, including contractual interest, late payment fees and collection fees. Where were Visa and Mastercard? Every dollar of "fake" value added to a car is lost for unsecured creditors in Chapter 13 cases.(see footnote 71)

Means-testing, of course, aims to increase returns to *unsecured* creditors by pushing more debtors into Chapter 13. But Chapter 13 for secured creditors has meant cram down, waiting months for payments to begin, and years under the automatic stay. Secured creditors have fared better in Chapter 7, where the debtor may reaffirm car debt in full, and the quick discharge eases the burden of reaffirmation payments. Chapter 7's automatic stay lasts months, not years, so if the debtor fails to pay, the secured creditor can retake the collateral. The no-cram-down rule would make Chapter 13 more acceptable to secured creditors. However, it will do so at the cost of reducing payments to unsecured creditors in Chapter 13, making Chapter 13 less attractive to debtors and increasing plan failure rates.

Page 544 PREV PAGE TOP OF DOC

H.R. 3150 goes even further for initial means-testing analysis. It presumes that debtors will retain all collateral and repay the full unpaid balance without cram-down. Not surprisingly, very few debtors can pay their non-housing secured debt in full in five years, cover the trustee's fees and priority taxes, and pay 20% of unsecured claims as well.

1. Living Expenses and the IRS Collection Financial Standards.

To find Projected Monthly Net Income, the bill starts with average monthly gross income for the six months prior to filing (the same income figure used in the median income test). From that figure, one deducts living expenses as well as payments on secured and priority debt. H.R. 3150 directs that living expenses for this test be based on the Collection Financial Standards (CFS) used by the Internal Revenue Service in tax payment plans.(see footnote 72)

H.R. 3150 turns to the CFS for guidance on reasonable living expenses, rather than relying exclusively on the debtor's scheduled expenses, which are widely viewed as inaccurate. Some say that debtors often inflate living expenses to avoid dismissal under section 707(b). Others say that when debtors' scheduled expenses are wrong, the errors are often on the low side, because many debtors do not keep track of actual amounts they spend for categories like food, clothing and transportation that require many small expenditures rather than one monthly check.

Many questions will arise with use of the CFS for means-testing. Two general questions will be treated here and others will be addressed in the discussion of the Projected Monthly Net Income Test below. The first is which version of the CFS to use. The IRS issues and updates the CFS on a somewhat irregular schedule. For example, the 1997 CFS were to be effective from and after April 14, 1997, while the 1998 CFS were to be effective from and after October 15, 1998.(see footnote 73) H.R. 3150 does not state whether one should follow IRS practice, that is, shift allowances in mid-year, or instead use the same set for the full calendar year. We assumed that, for means-testing purposes, the CFS should be used in the same way as the national income medians from the Census Bureau. That is, one should use the most recent CFS that is available January 1st for all cases filed in that calendar year. Administratively, this would be substantially simpler, especially if the IRS continues to adjust the CFS on an irregular schedule. Trustees, attorneys for debtors and creditors, makers of bankruptcy software, and others could adjust their computer programs at the same time once a year for new national medians and new CFS.

Page 545 PREV PAGE TOP OF DOC

A second problem is that the CFS are not, for the most part, designed as allowances. Instead, under IRS practice at least, several CFS categories are maximums and the taxpayer is allowed only the lesser of actual expenses or the CFS limit.(see footnote 74) Again, it is unclear if H.R. 3150's drafters intended to follow that IRS practice or instead, for purposes of means-testing, to use the CFS as straight allowances. Both we and Ernst & Young(see footnote 75) assumed that H.R. 3150 intended the CFS to be used in means-testing as allowances, not merely as maximums. We made this assumption for several reasons. First, use as allowances addresses both of the alleged shortcomings in debtors' scheduled expenses. If the debtor's expenses are too high, the CFS will limit them. If they are unrealistically low, use of the CFS as an allowance, rather than reliance on the debtor's actual scheduled expenses, will produce a more realistic budget and, hence, generate a better prediction of ability to repay. Much of the utility of the CFS for means-testing purposes would be lost if debtors and trustees had to collect evidence of and calculate the debtors' actual expenses for categories covered by the CFS. While it is easy to determine a monthly rent or mortgage payment, it is much more difficult to keep track of all monthly transportation or food expenses for a family of five, for example.

What did we do for our sample? We did not resurrect the CFS actually in effect as of January 1, 1995. Instead, we used the CFS version promulgated in 1997 and reduced those allowances to 1994 dollars,(see footnote 76) because the 1994 CFS would have been in effect as of January 1, 1995. We chose that route in case there had been any structural changes to the CFS, in addition to increased dollar amounts. Since means-testing, if adopted in a version using CFS, would have to use the post-1997 structure, it seemed best for our test drive to use the version closest to that considered for adoption.

Page 546 PREV PAGE TOP OF DOC

The four CFS categories are: 1) Food and Clothing, 2) Housing and Utilities, 3) Transportation and 4) Other Necessary Expenses. The first three categories set specific monthly dollar amounts.(see footnote 77) The Other Necessary Expenses category is apparently left to the discretion of IRS agents (or in bankruptcy, perhaps the U.S. Trustee and the bankruptcy judge). It is helpful to have objective guidance on allowable expenses, but if the CFS understates actual and reasonable expenses, projected repayment capacity will be overstated under H.R. 3150.(see footnote 78)

a. *CFS Food and Clothing Allowance.* The Food and Clothing Allowance, for "food, clothing and clothing care, housekeeping supplies, personal care products and services, and miscellaneous,"(see footnote 79) presents no particular interpretive problems, because it is a national standard that does not vary by location (except for Alaska and Hawaii). The situation is not nearly so simple, however, with the rest of the CFS under H.R. 3150.

b. *CFS Transportation Allowance.* The CFS Transportation Allowance is subdivided into a uniform national standard for Ownership expense and local standards (adjusted for cost-of-living) for Operating expense (or Public Transportation expense if the debtor does not own or lease a car). The Operating Allowance covers "insurance, registration fees, normal maintenance, fuel, . . . parking and tolls,"(see footnote 80) for cars owned or leased. We read the CFS to limit Ownership and Operating Allowances to one car for households of one and no more than two cars for households of two or more. Debtors who did not own or lease a car were allowed one Public Transportation Allowance regardless of family size. For larger families, these limits may understate reasonable transportation expenses.

Page 547 PREV PAGE TOP OF DOC

The Ownership Allowance covers lease or purchase of up to two motor vehicles.(see footnote 81) Integrating this particular CFS allowance into means-testing is complex because H.R. 3150 treats payment of secured debt separately from living expenses, while two CFS categories (Transportation and Housing and Utilities) include repayment of secured debt. Without adjustment, payments for homes and cars would be counted twice. To avoid such double-dipping, H.R. 3150 directs that one "exclud[e] payments for debts" from the CFS allowances.(see footnote 82)

To follow that mandate, we first calculated a monthly payment that would amortize all secured car debt over 60 months. Next, we subtracted that monthly car payment from the Ownership portion of the Transportation Allowance. If there was a remainder, however, we treated it as an allowable expense. Ernst & Young, on the other hand, disallowed the CFS Ownership component altogether, and merely amortized existing motor vehicle debt over 60 months.

To see the dollar difference this makes over five years, look at the example in Table 3 below. The IRS in 1997 allowed $335 a month for Ownership costs, separate and apart from Operating costs. H.R. 3150 is more generous than the IRS; the bill assumes for means-testing analysis that debtors will repay all prepetition car debt (even payments for a luxury car that greatly exceed the CFS Ownership Allowance). H.R. 3150 directs one to amortize all car debt, however high, over 60 months.

Table 4

Assume Debtor A bought a luxury car just a month before filing. Debtor A's high monthly car payments exceed the IRS allowance, so neither Ernst & Young nor we would give Debtor A any Ownership Allowance. Her car is new, however, and likely to run well for five years, so that may not be unrealistic.

Page 548 PREV PAGE TOP OF DOC

Debtor B, on the other hand, was more frugal; she filed bankruptcy owning an eight-year old car that was paid off.

Her eight-year old car is *not* likely to run another five years (it would then be 13 years old!) without major repairs or replacement. Ernst & Young, however, would deny Debtor B any Ownership Allowance. Our interpretation, on the other hand, affords Debtor B her CFS Ownership Allowance, to cover a transmission transplant or a purchase at some point of a newer model. The difference over 60 months is $20,100. This is how Ernst & Young found much of the money they claim would be available for unsecured creditors—by assuming all cars, no matter how old, would run five more years. That assumption will prove false, and that money will not be available for unsecured creditors, for if the debtor cannot get to work, she cannot pay anyone.

One cannot understand the full impact of Ernst & Young's approach without a closer look at our debtors' cars, especially the age of those cars. This is old car territory, even very old car territory. Debtors in more than 80% of our 1,041 sample cases owned a car;(see footnote 83) altogether they owned about 1,300 cars. Yet the debtors scheduled only 696 claims secured by motor vehicles. We at first found it hard to believe so many cars were free of debt. Further checking, however, revealed that most cars in the sample were at least five model years old when the debtors filed their Chapter 7 cases. Even older cars were not always debt-free: 267 cars with secured debt were five or more model years old at time of filing; 82 with secured debt were 10 or more years old.(see footnote 84) Due to the debtors' financial distress, these cars may not have received regular maintenance. Most of these older cars would need major repairs and many might have to be replaced over the next five years.(see footnote 85) The debtors need reliable transportation to earn the income which H.R. 3150 presumes will continue unabated all that time.

Page 549 PREV PAGE TOP OF DOC

Remember that we are forecasting car purchase/lease repair costs for five years into the future under H.R. 3150. To deny the CFS Ownership Allowance altogether, as Ernst & Young do, and amortize preexisting car debt only, seriously understates necessary and foreseeable car-related expenses. First, debtors who lease rather than buy get no allowance under Ernst & Young's method even for current monthly lease payments. Second, the many debtors who come into bankruptcy with older cars get no allowance for major repairs or eventual replacement. This interpretation increases the already substantial incentive to buy a car shortly before filing. After all, it may be the debtor's last chance for five years.(see footnote 86)

To measure the impact on means-testing outcomes, we tried Ernst & Young's method on the 215 sample cases which passed the median income test. When we held all other variables constant, but denied the Ownership Allowance, the number of can-pays nearly doubled, to 70 cases. We believe that a substantial part of the difference between Ernst & Young's results and our own results is due to the treatment of motor vehicle expense.

The CFS Ownership Allowance, when used for a five-year forecast, must be read to cover not only current car debt, but also leasing, major repairs, and in some cases, eventual replacement of aging or damaged vehicles. Because Ernst & Young omit these other reasonable expenses, their report seriously overstates repayment capacity.

c. *CFS Housing and Utilities Allowance.* The CFS Housing and Utilities Allowance covers monthly rent, mortgage payments, utilities, property taxes, homeowner's and renter's insurance, maintenance and repairs, homeowner dues and condominium fees. It is adjusted for cost of living to the county level.(see footnote 87)

Page 550 PREV PAGE TOP OF DOC

H.R. 3150's mandate to exclude debt repayment from the CFS allowances applies to home mortgage payments. As with cars, H.R. 3150 ignores the CFS cap on total monthly housing expenses to allow full payment of housing debt (to the extent due under the original contract within the 60 months after the petition).

Excluding debt repayment is more complex for Housing than for Transportation, because the IRS does not subdivide the Housing and Utilities Allowance into ownership and operating portions. The IRS gives no direction as to how much of this lump-sum allowance should be preserved for utilities, maintenance, property taxes, insurance and other related expenses. We followed the method used by Ernst & Young,(see footnote 88) giving renters the CFS Housing and Utility Allowance, but treating homeowners differently. For homeowners, both we and Ernst & Young substituted the amounts scheduled by the debtor for monthly mortgage payments, maintenance, property taxes and insurance (if not included in the mortgage payment), and utilities (other than cable television which we disallowed). We, like Ernst & Young, allowed these expenses in full,(see footnote 89) even if they exceeded the CFS Housing and Utilities Allowance.

d. *CFS Other Necessary Expense Allowance.* The Other Necessary Expense category has no fixed dollar amounts, and is intended to cover a wide variety of actual expenses.(see footnote 90) Under this heading we, like Ernst & Young, allowed expenses as scheduled by the debtor for tax and social security withholdings, union dues, work uniforms, alimony and child support, child care, regular business expenses, life, health, and disability insurance, taxes other than those withheld by the employer (unless it appeared that the same taxes were listed as priority claims on Schedule E), charitable contributions and medical/dental expenses. We disallowed, on the other hand, debt payments withheld from the paycheck, transfers into savings plans and pension contributions except in the one case where the debtor stated the contribution was mandatory. We also disallowed all payments for dependents not at home (other than alimony and support) and tuition payments.

Page 551 PREV PAGE TOP OF DOC

As this recitation shows, use of the IRS CFS to budget for means-testing still requires detailed examination of and judgments about each debtor's scheduled expenses. This will be time-consuming, expensive, and, inevitably, the source of much litigation under any means-testing regime.

2. Additional Expenses Required by Extraordinary Circumstances and the Tithing Bill.

In addition to the CFS allowances, H.R. 3150 has a wild card category for "extraordinary circumstances."(see footnote 91) To claim additional expenses under this heading, the debtor and her attorney must file a sworn statement describing the expense and the circumstances. If the trustee objects, a hearing will be held and the debtor has the burden of proof. Our finding that 3.6% are can-pays assumes that no sample debtors had expenses of this type.(see footnote 92)

(i) a written statement that [the extraordinary circumstances part of the bill] applies in determining the debtor's eligibility for relief under chapter 7 of this title; . . .
(iii) . . . a list itemizing each additional expense which exceeds [the CFS];
(iv) a detailed description of the extraordinary circumstances that explain why . . . each additional expense itemized under clause (iii) requires allowance; and
(v) a sworn statement signed by the debtor and, if the debtor is represented by counsel, by the debtor's attorney, that the information . . . is true and correct.

Page 552 PREV PAGE TOP OF DOC

H.R. 3150 §101(4).

However, extraordinary circumstance expenses may become very ordinary indeed, under the Religious Liberty and Charitable Donation Protection Act of 1998 or "Tithing Act."(see footnote 93) The Tithing Act allows debtors in Chapters 7 and 13 to donate 15% of their annual gross income (and sometimes more) to qualified churches and charities. Such donations, the Act states, are not constructive fraudulent transfers, nor are they disposable income in Chapter 13 or evidence of substantial abuse in Chapter 7.(see footnote 94) If, as some commentators urge, no prior history of giving is required, the Tithing Bill gives new meaning to the phrase "eve-of-bankruptcy conversion."

H.R. 3150's section 118(d) would extend the Tithing Bill into means-testing. It directs that qualified donations up to 15% of the debtor's annual gross income "*shall* be considered . . . additional expenses of the debtor required by extraordinary circumstances."(see footnote 95) One wonders whether the right hand knew what the left hand was doing here. Means-testing is intended to benefit unsecured creditors by pushing can-pay debtors into Chapter 13. The Tithing Act and section 118 of H.R. 3150, however, seem to offer the same debtors a way out. As one commentator put it, "any attorney worth his salt is going to include within projected expenses 15% of . . . gross income for . . . contributions. . . . To do otherwise probably would require notification to the E&O carrier of a potential claim."(see footnote 96) For almost all debtors, charitable donations of 15% of gross income, on top of other expenses and debt payments, would reduce projected monthly net income to zero, enabling them to avoid can-pay status.

Page 553 PREV PAGE TOP OF DOC

Our sample, like Ernst & Young's, was collected before the Tithing Act passed, so we cannot directly measure its impact. None of our sample debtors scheduled charitable contributions even close to 15% of gross income. However, we retested our 37 can-pay debtors, this time assuming they made qualified contributions of 15% of gross income in each of the five years after filing. In that scenario, well under one percent (six of 1041) had enough projected monthly net income to repay 20% of nonpriority unsecured debt.

3. Secured Debt Payments.

After deducting allowable monthly expenses from monthly gross income, we moved on to the second component of the Projected Monthly Net Income Test: monthly debt repayment. As noted above, H.R. 3150's means-testing provisions assume full amortization of priority and non-real estate secured debt, plus maintenance of regular monthly payments on real estate debt, before repayment of general unsecured debt. Thus, one must calculate total monthly payments on secured and priority debt (at least to the extent that payments would have been due within the 60 months after the petition).

a. *Secured Debt.* There are several problems with using current Official Bankruptcy Forms to project secured debt payments under H.R. 3150. First, neither the term nor the interest rate is disclosed for non-housing claims; only the unpaid balance is available. Second, the schedules do not clearly separate homeowners from renters, yet the distinction is important for several purposes under this analysis. One must make that judgment based on comparison of the debtor's address with real property or mobile homes on Schedules A and B and then examine Schedules C (exempt property) and D (secured claims). Third, one cannot tell whether the debtor is behind on house or car payments. In Chapter 13, such a debtor would have to make cure payments in addition to regular car or mortgage payments until the arrearage is paid.(see footnote 97) For this study, we assumed "no default, no cure," and therefore only a single level monthly payment on each secured debt. However, this clearly understates required payments for debtors in default.

Page 554 PREV PAGE TOP OF DOC

We followed Ernst & Young's methods for housing debt, allowing deduction of home mortgage payments from Schedule J in the living expense calculations as discussed above, and excluding home mortgage debt from the treatment for other secured debt described below. One complexity in this area is the need to separate home mortgage debt from debt secured by other real property. For home mortgages, we used as the monthly payment whatever amount the debtor entered on Schedule J for "Rent or Home Mortgage Payment."(see footnote 98) However, some debtors who rent their living quarters (and thus make regular monthly rent payments) also own real estate subject to one or more mortgages. For example, 65 debtors in our sample owned (and had mortgaged) real estate other than their primary residence. They owned apartment buildings, farmland, vacation condos, and unfinished "spec" homes. If one mistakes such a debtor for a homeowner, and treats her rent as a home mortgage payment, one will omit her additional "Other Real Estate" payment, and overstate repayment capacity.

Similar problems occur for homeowners with two or more home mortgages and for owners of mobile homes when the house and lot are separately financed. Schedule J does not reveal whether the "Rent or Home Mortgage" amount is the sum of monthly payments on all the mortgages or not, and without term and interest rate data, it is impossible to distill the truth from the files.

For debts secured by real property or mobile homes other than the debtor's primary residence, only the claim amount was available from the schedules. To follow H.R. 3150's direction to project repayment only of amounts in fact due within 60 months,(see footnote 99) we had to construct an artificial amortization schedule. Claims of $20,000 or more were amortized over 15 years at 9%; only the resulting level monthly payment was deducted from the debtor's monthly income. Other real estate debts of less than $20,000 were fully amortized over 60 months at 9% like non-real estate secured debt. Ernst & Young's report does not discuss treatment of non-housing real estate debt.

Page 555 PREV PAGE TOP OF DOC

All non-real estate secured debt (and other real estate claims under $20,000) were treated as due within five years.(see footnote 100) We generally followed Ernst & Young's methods here, grossing up the claim amount to simulate interest, then dividing by 60 to get an assumed monthly payment.

However, Ernst & Young grossed up such debt by 10%, equivalent to interest at 9% for only two years.(see footnote 101) However, we are amortizing these claims over *five* years, not two. Therefore, we added 24% to principal, to simulate interest at 9% for five years. We suspect automobile lenders and furniture dealers will not settle for two years' interest on five-year loans. By understating required secured debt payments, Ernst & Young have overstated unsecured debt repayment capacity. We suspect that many Chapter 7 debtors have borrowed in the subprime market where interest rates are significantly higher than 9%. To that extent, we have also overstated unsecured debt repayment capacity.

4. Priority Claims.

a. *Prepetition Priority Claims*. Prepetition priority claims were taken from Schedule E, with care to include only that portion of the claim entitled to priority if the debtor gave that additional information. We also excluded student loans, which debtors frequently scheduled as priority rather than the general unsecured claims they are. We divided the total by 60 to get one month's prepetition priority debt payment.(see footnote 102)

Page 556 PREV PAGE TOP OF DOC

b. *Priority Expenses of Administration in Chapter 13*. H.R. 3150 directs that priority claims be "estimated,"(see footnote 103) recognizing that post-petition expenses of administration are an important part of total priority debt, entitled to first priority under section 507(see footnote 104) of the Code in a Chapter 13. Most creditor-funded studies, however, have omitted these expenses. For example, Ernst & Young assumed that the debtors' attorney fees would be paid in full before filing, although that is almost never true in Chapter 13.(see footnote 105) As for Chapter 13 trustee's fees, their report stated only that "administrative expenses would necessarily rise for the petitions that are converted to Chapter 13."(see footnote 106) They then proceeded to ignore these expenses in their calculations. We, on the other hand, estimated and deducted these expenses when calculating Projected Monthly Net Income.

Chapter 13 trustees are compensated by a percentage of payments made through Chapter 13 plans.(see footnote 107) We used the rate of 5.6% (the 1995 national average Chapter 13 trustee's fee computed as a percentage of disbursements).(see footnote 108) This is a conservative figure for two reasons. First, the national average Chapter 13 trustee's fee rose after 1995, and this would have impacted these debtors in a five-year plan. Second, under H.R. 3150, Chapter 13 trustees would have additional duties, so the percentage fee might rise to cover their increased expenses. We applied the 5.6% fee to prepetition priority claims and to secured debt (other than home mortgages and other real estate claims of $20,000 or more, which we assumed would be made by the debtor outside the plan).(see footnote 109)

Fee credit is frequently extended by debtors' counsel in Chapter 13 cases. In Chapter 13, unpaid fees are treated as administrative expenses and paid through the plan.(see footnote 110) We assumed that attorney fees paid through the plan and the trustee fee thereon would total $800 for our sample debtors. This added $13 a month to monthly expenses in each sample case. This amount is a reasonable estimate of 1995 practice, based on a 1996 study by the National Association of Consumer Bankruptcy Attorneys (NACBA), which found that the average total attorney fee in Chapter 13 was $1,281, with $428 paid up front, and the balance of $853 paid through the plan(see footnote 111) subject to the trustee's percentage fee.

Page 557 PREV PAGE TOP OF DOC

Final Calculation of Projected Monthly Net Income.

Once living expenses, extraordinary circumstances expenses and payments on secured and priority debt (including administrative expenses) have all been deducted from monthly gross income,(see footnote 112) the remainder, if any, is called Projected Monthly Net Income by H.R. 3150.(see footnote 113) If the debtor's Projected Monthly Net Income is $50 a month or less, the debtor is eligible to remain in Chapter 7. On the other hand, if the debtor has more than $50 a month remaining, the debtor must proceed to the third and final portion of H.R. 3150's three-part means-test.(see footnote 114)

Table 4 shows how our sample fared on this test. Only 45 of our sample debtors had Projected Monthly Net Income over $50, for a weighted pass rate of 4.07%. Ernst & Young, by contrast, found that 17% of their sample had more than $50 Projected Monthly Net Income.(see footnote 115) We believe the differences are due to use of different medians, different treatment of motor vehicle expenses, interest on secured debt for five rather than two years and our inclusion of Chapter 13 administrative expenses.

Table 5

Weighted pass rate = 4.07%(see footnote 116)

We have serious questions as to the feasibility and cost-effectiveness of applying this complex test to hundreds of thousands of Chapter 7 filers each year. As has been shown, H.R. 3150's Projected Monthly Net Income test is labor intensive, and heavily dependent upon the accuracy of debtor's schedules regarding debts and expenses. Sophisticated debtors can manipulate the outcome by increasing their secured debt and charitable contributions.

Page 558 PREV PAGE TOP OF DOC

C. The 20% of Unsecured Debt Test.

The third, final and mercifully simpler test under H.R. 3150 is whether the debtor's Projected Monthly Net Income is sufficient to repay at least 20% of her nonpriority unsecured debt over five years.(see footnote 117) The steps we took to apply this test follow.

First, we multiplied Projected Monthly Net Income by 60 to get the total amount available for general unsecured claims. Second, because Chapter 13 trustees collect fees on payments to nonpriority unsecured creditors, we multiplied that total by .9469 (in effect reducing it to reflect the trustee's 5.6% fee). Finally, we divided this adjusted Projected Five-Year Net Income by total nonpriority unsecured debt(see footnote 118) to project the percentage the debtor could repay over 60 months.

As Table 5 shows, only 37 of our sample debtors, or 3.55% on a weighted basis, had sufficient income to meet or exceed H.R. 3150's 20% threshold. Ernst & Young reported that 15% of their sample emerged as can-pays when it used 75% of the median. At 100% of the median, 11% of their sample were can-pays.(see footnote 119)

Table 6

Weighted pass rate = 3.55%(see footnote 120)

Page 559 PREV PAGE TOP OF DOC

The Can-Pay Debtors

The 3.6% of our sample identified as can-pays have median annual gross incomes of $52,080, almost two and one-half times the median income of the can't-pays ($20,688), and more than twice that of the whole sample ($21,264).

The can-pays' median incomes are also well above the 1995 national median for all families ($40,611). See Tables 6 and 7 below, which use the term "impacted filers" for can-pays.

63593y.eps

Table 7

Median nonpriority unsecured debt among the can-pay debtors was $33,526, while for the rest of the sample, the median was $20,303.

Who are these can-pays? In Appendix A, we profile each can-pay case. These debtors are truck drivers and engineers, mechanics and restaurant managers, a young couple expecting twins, retirees with part-time jobs, one man with a serious gambling problem, a married couple who ended up deeply in debt by caring for and eventually burying their parents. Several got into financial trouble when their small business failed. At least one family matches the stereotypical abuser, with income of $90,000, homes in California and Hawaii and $72,000 in credit card debt.

Many of the can-pays had the apparent capacity to repay well over 20%; in fact, average repayment capacity for nonpriority unsecured debt was 74.6%, and 14 of the 37 could repay 100%. However, these repayment percentages are merely forecasts based on the same shaky foundation of the VISA report: that for five years, these debtors' income will rise as quickly as expenses and debts. We critically examine that premise in the next section.

Page 560 PREV PAGE TOP OF DOC

PART III—PROJECTED NET GAIN AND THE IMPOSSIBLE DREAMS.

How much more might unsecured creditors collect under means-testing? VISA estimated that number at "over $4 billion,"(see footnote 121) then qualified that estimate by stating "[t]his assumes that income remained unchanged relative to expenses and liabilities during the 60 month repayment period."(see footnote 122)

In 1997, some 926,000 nonbusiness Chapter 7 cases were filed. If we assume that our sample holds for the nation as a whole and that 3.55% or 32,873 were can-pays, each with nonpriority unsecured debt of $35,303,(see footnote 123) and that each could repay 75% or $26,477 of that unsecured debt. If all 32,873 debtors repaid $26,477 apiece, it would total about $870 million, nowhere close to VISA's estimate. However, even that $870 million is based on at least four unrealistic assumptions:

First, that well-counseled debtors will not evade can-pay status by increasing debt or charitable contributions;

Second, that the debtors' incomes, expenses and debts will remain relatively unchanged for five years;

Third, that 100% of the can-pays will file and complete five-year Chapter 13 plans; and

Page 561 PREV PAGE TOP OF DOC

Fourth, that unsecured creditors will bear no part of the cost to sort all Chapter 7 cases for means-testing and to monitor the 30,000 + can-pays over five years in Chapter 13.

Fifth, that unsecured creditors collect nothing from Chapter 7 debtors at present.

None of these assumptions is well-founded. The first four are impossible dreams and the last is simply untrue. Let's start with the first, the assumption that well-counseled debtors will not choose to avoid can-pay status by increasing debt or charitable contributions prior to filing. As discussed above, the Tithing Bill allows debtors to divert up to 15% of annual gross income into H.R. 3150's extraordinary expense category. We also pointed out the incentives to increase secured debt, especially by buying a car, prior to filing. Many debtors with above-median income could and some would use these routes to escape five years of payments in Chapter 13. If we conservatively assume that only one-quarter of the can-pays would do so, that reduces the can-pay pool to 25,000 debtors and reduces net gain to about $700 million.

Now let's consider the likelihood that for five years, the incomes, expenses and debts of the can-pay debtors will remain relatively stable. Truly, this is an impossible dream. Over five years, of course, some will die. The rest will get five years older and many will be deeper in debt. Like other human beings, the can-pays will suffer disease, divorce, disability and downsizing that for some will substantially reduce income and increase expenses. Even delightful events like new babies entail years of additional expenses and, eventually, student loans. None of these events is stopped by the automatic stay. As the GAO remarked with reference to VISA's studies, there is "no empirical basis for assuming five years of stable income and expenses."(see footnote 124)

Page 562 PREV PAGE TOP OF DOC

Another impossible dream is that the can-pays would file and complete a five-year Chapter 13 plan. It is common knowledge that current voluntary Chapter 13 plans have only a 30% completion rate, and many of these were just three-year plans to begin with.(see footnote 125) To be sure, the can-pays would be a select group, with above-average ability to repay at the outset, so one could expect a better completion rate, perhaps as high as 50%. But for all the reasons set forth above, plus sheer bad luck and for some, bad habits, many will not finish their plans.(see footnote 126) If only half of these 25,000 plans fail, after making payments for an average of two and one-half years, that would reduce net gain to about $525 million.

The fourth impossible dream is that it will cost unsecured creditors nothing to sort a million Chapter 7 cases a year into can- and can't-pays. Perhaps all these costs can be shifted to taxpayers, but there will be real costs, as the CBO has shown,(see footnote 127) and unsecured creditors are taxpayers too. But let's be conservative here too. The CBO estimates that H.R. 3150's provisions as a whole would cost $214 million in the first five years, plus another $8–16 million a year for additional judges needed for means-testing.(see footnote 128) Assume that only $25 million of these costs are born by unsecured creditors either directly due to higher Chapter 13 administrative costs, or indirectly through increased taxes. That brings us down to $500 million.

Finally, the VISA studies also assume that unsecured creditors collect nothing from Chapter 7 debtors at present. This is false. Chapter 7 debtors frequently reaffirm debts scheduled as unsecured.(see footnote 129) They must also repay student loans and other nondischargeable unsecured debts. Let's assume that all such payments by 1997 Chapter 7 filers amount to $50 million. This $50 million is not new money dependent on means-testing; unsecured creditors already collect that much. So we subtract $50 million from our $500 million, giving us a projected net gain of $450 million.

Page 563 PREV PAGE TOP OF DOC

In seeking that pot of gold from the can-pay minority, however, it is vital that we not bar the many can't-pays from a fresh start. Means-testing would be mean indeed if it hurt the many to capture the few.

CONCLUSION

Our intent in this article is to assess, by means of a test drive of sorts, whether one suggested legislative response to perceived bankruptcy abuse would fulfill its apparent aims. That is, would H.R. 3150's formula find debtors with ability to repay and divert them into Chapter 13 plans that would produce a net gain to unsecured creditors without undue cost to other debtors and taxpayers?

As we have shown, H.R. 3150's formula produces relatively few apparent abusers for diversion into Chapter 13.(see footnote 130) Second, because the sample cases were filed in 1995, when the only sanction for abuse was section 707(b) dismissal, debtors and their attorneys had less reason to take evasive maneuvers. At this writing, of course, the Religious Liberty and Charitable Donation Protection Act of 1998 is in force, providing an escape route for all but the wealthiest few. Further, incentives to load up on secured debt, especially by purchasing a new car shortly before filing, are substantially increased. Thus, there is reason to believe that the number of can-pays in our sample is substantially higher than would be found today if means-testing were adopted. Third, the assumed benefits to unsecured creditors from means-testing depend very substantially on whether those can-pay debtors in fact convert to and complete lengthy Chapter 13 plans. Chapter 13's recent history provides little reason to believe that even a bare majority of the debtors would in fact complete their plans. The net gains to unsecured creditors, in sum, appear small relative to the costs likely to be imposed on the great majority of Chapter 7 debtors, as well as trustees, judges and taxpayers. In sum, we conclude that means-testing as enshrined in H.R. 3150 will not go the distance.

Page 564 PREV PAGE TOP OF DOC

APPENDIX A—MEET THE CAN-PAY DEBTORS

Here we briefly describe each of the 37 can-pay cases from our sample, so that readers may make their own assessments on the prospect for repayment from these debtors. The cases are listed by district and then in ascending order by monthly gross income. We include the debtors' gender, marital status, number of dependents, occupation, gross monthly income, total secured, priority and nonpriority unsecured(see footnote 131) debt and prior bankruptcies, if any. Unfortunately, debtors are not asked to disclose their age on the schedules, though that information would be relevant to a five-year forecast of repayment capacity. We also indicate whether the debtors are homeowners and give the age and make of their cars. If the debtors reaffirmed any debts, we include the amount and type of debt. We also set forth the percentage of non-priority unsecured debt that H.R. 3150's formula predicts the debtors would repay over five years assuming stable income and expenses. Finally, we identify the six can-pay cases in which at least 20% of non-priority unsecured debt could still be repaid even if the debtors contributed 15% of gross income to charity under the Tithing Act.

California

California Case #1 Husband is an auto mechanic and wife is disabled (apparently injured on the job in 1994). We treated them as a household of two, but there may be more family members for debtors describe part of their social security disability income as "for the kids." Their income was $4,340 at the time of filing, but the husband may have been out of work part of 1995. They owe $28,404 secured, $0 priority and $51,302 unsecured (much of it credit card debt). They are not homeowners. They lease a 1994 Mustang and own a 1986 Nissan pickup. In the year before they filed, Ford repossessed a 1993 Taurus, and AVCO recovered a judgment. Debtors' projected monthly net income would repay 50.8% of non-priority unsecured debt over five years.

Page 565 PREV PAGE TOP OF DOC

California Case #2 Both husband and wife are truck drivers for a national moving company, and they have no dependents. Their income is $5,325, but total 1995 income will be only 60% of 1994's. They owe $6,467 secured (boat), $0 priority, and $52,588 unsecured. They own a 1989 Chevy and a 1986 boat, and are not homeowners. No collection activity is noted. Debtors reaffirmed the boat debt ($5,787) and one unsecured debt ($786). Debtors' projected monthly net income would repay 74.3% of non-priority unsecured debt over five years.

California Case #3 Debtor, a single male with no dependents, is an engineer with income of $5,500. He owes $13,809 secured, $0 priority, and $51,478 unsecured. He is not a homeowner. He owns a 1990 Nissan with $12,769 still owed on it. He may have filed to discharge $25,772 in dischargeable federal income taxes plus a $10,400 line of credit from HFC. No collection activity is noted. Debtor reaffirmed his car loan and two unsecured debts ($2,500). Debtor's projected monthly net income would repay 68.3% of non-priority unsecured debt over five years.

California Case #4 Debtor, a single woman, has custody of a three-year old nephew. She is a realtor, but took a second job at a cell phone firm when a declining real estate market halved her realty income. Her income was back up to $6,318 at the time of filing. She owes $93,670 secured, $3,000 priority taxes, and $59,367 unsecured (mostly credit card and retail charge card debt). She and her parents co-own a home and live together. Debtor may own other unscheduled real estate because she lists a monthly mortgage payment of $1,300 in addition to her house payment (or it could be an unscheduled second mortgage on her home). She owns a 1993 Lexus. She lists $1,040 a month for daycare. No collection activity is noted. Debtor reaffirmed an unsecured debt ($500). Debtor's projected monthly net income would repay 100% of non-priority unsecured debt over five years. This case is one of the six can-pay cases where debtor would still be able to repay at least 20% of non-priority unsecured debt even if charitable contributions of 15% of gross income were made under the Tithing Act.

Page 566 PREV PAGE TOP OF DOC

California Case #5 Husband, a salesman (4 years) and wife, not employed, have two sons, 13 and 2. Their income is $7,535, of which $3,500 is base salary and the rest commissions averaging $4,035. Their income was 10% lower in 1995 than in 1994. They owe $208,486 secured, $1,200 priority taxes, and $72,741 unsecured (all credit card and retail charge card debt). They own a home in California, a time-share in Hawaii, a 1990 Ford Thunderbird and a 1990 Acura Legend. The husband lists business expenses of $730 per month for entertainment, cell phone and pager. There are several judgment liens on their home. No other collection activity is noted. Debtors' projected monthly net income would repay 37.9% of non-priority unsecured debt over five years.

Colorado

Colorado Case #1 The debtor, a divorced male with no dependents, is an Army retiree who works in technical support for a software firm. His income is $2,816. He owns a mobile home and a 1994 Jeep Wrangler. He owes $27,152 secured (mobile home and car), $0 priority and $33,405 unsecured, including a student loan for $2,200. No repossessions, foreclosures or garnishments were noted. Debtor reaffirmed two unsecured debts for a total of $3,569. Debtor's projected monthly net income would repay 57.6% of non-priority unsecured debt over five years.

Colorado Case #2 Husband installs sprinklers for a fire protection company and wife is a floral designer. They have no dependents. Their income is $2,997. They do not own a home or a car. They pay $260 a month for a 1991 Chevy, which debtors apparently lease from the wife's family. No recent garnishments, attachments or foreclosures were noted, but they owe a deficiency for a car repossessed in 1988, and were evicted from an apartment in 1991/1992. Debtors' projected monthly net income would repay 100% of non-priority unsecured debt over five years.

Page 567 PREV PAGE TOP OF DOC

Colorado Case #3 The debtor, a single female with no dependents, is a social worker whose income is $3,430. She owes $87,400 secured (home and car), $0 priority and $46,017 unsecured. She owns a home and a 1995 Saturn. She may have been out of work prior to filing; she filed in November but lists year-to-date income at only $23,000. In 1994, she made $34,262. Although no current collection suits are noted, she owes a deficiency of $26,000 from foreclosure on a former home. Debtor's projected monthly net income would repay 39.2% of non-priority unsecured debt over five years.

Colorado Case #4 Husband is a sergeant in the Army National Guard, wife is disabled and unemployed. They have no dependents. Their income is $3,512, of which $477 is wife's disability payments. The debtors own a home as well as a 1992 Dodge LeBaron and a 1972 Dodge Coronet. Secured debt is $93,336 (house, car and furniture), priority debt is $419 (taxes) and unsecured debt is $31,057. No garnishments, executions or foreclosures were noted. Debtors reaffirmed $17,834 on the LeBaron. Debtors' projected monthly net income would repay 86.9% of non-priority unsecured debt over five years.

Colorado Case #5 The debtor, a single male with no dependents, collects retirement pay from a manufacturing company, but continues to work as a contract representative for a supply firm. His income is $4,222. He owes $73,950 secured (home and auto), $8,200 priority (tax) and $39,380 unsecured (much of it credit card). He owns a home and a 1989 Dodge Dynasty. No garnishments, attachments or collection suits were noted. Debtor's projected monthly net income would repay 100% of non-priority unsecured debt over five years. This case is one of the six can-pay cases where debtor would still be able to repay at least 20% of non-priority unsecured debt even if charitable contributions of 15% of gross income were made under the Tithing Act.

Page 568 PREV PAGE TOP OF DOC

Colorado Case #6 Husband, a metal spinner, and wife, an engineer, have two teenage children. Their income is $4,427. The husband was out of work at times in 1994 and 1995. They owe $14,506 secured, $822 priority (tax) and $24,196 unsecured. Much of the unsecured debt is medical, nursing home and funeral expenses for debtors' parents. The debtors are not homeowners and indicated they would surrender their 1990 Plymouth van. The debtors filed an earlier bankruptcy in 1984. Their mobile home was repossessed in 1993 and one creditor was garnishing debtors' wages. Debtors went to credit counseling before they filed. Debtors' projected monthly net income would repay 98% of non-priority unsecured debt over five years.

Colorado Case #7 The husband, a dispatcher, and the wife, a bookkeeper, are expecting a child, but currently have no dependents. Their income is $4,448. They owe $17,456 secured (car), $4,026 priority (tax) and $18,154 unsecured. The debtors are not homeowners. They own a 1991 Ford Ranger and a 1992 Hyundai. One collection suit was pending when the debtors filed. Debtors' projected monthly net income would repay 100% of non-priority unsecured debt over five years.

Colorado Case #8 Husband works at a private school and wife works in social services. They have a 16-year old son. Their income is $4,458. They owe $6,182 secured, $9,075 priority (tax) and $42,474 unsecured, including $9,000 in student loans. The debtors are not homeowners. They lease a 1993 Nissan Sentra and own a 1980 Datsun pickup. Their income had declined prior to filing. When they filed 11 months into 1995, their year-to-date income was only 80% of what they made in 1994. Debtors reaffirmed a furniture debt for $214. Debtors' projected monthly net income would repay 30.2% of non-priority unsecured debt over five years.

Colorado Case #9 Husband and wife are both truck drivers and have no dependents. Their income is scheduled as $4,560, but it varies. The debtors' income was much lower in the two years before filing: $17,860 in 1993 and only $6,700 in 1994. They owe $10,352 secured, $0 priority and $8,494 unsecured (principally credit card debt and a $700 phone bill). The debtors own a home valued at $30,000 with no scheduled mortgage debt. They own a 1987 Ford F–550 pickup, but the stay was lifted in their Chapter 7 to allow repossession of this truck. After the stay was lifted, the debtors twice failed to appear at the first meeting of creditors, so the case was dismissed and they did not receive a discharge. Debtors' projected monthly net income would repay 100% of non-priority unsecured debt over five years.

Page 569 PREV PAGE TOP OF DOC

Georgia

Georgia Case #1 Husband, a maintenance man, and wife, a chemical plant worker, have a one-year old child. Their income is $3,492. They owe $60,523 secured, $0 priority, and $23,430 unsecured. They are not homeowners. They own a 1994 Honda Civic and a 1991 Jeep Wrangler. They are in the process of a divorce. Several collection suits have been filed. They reaffirmed three secured debts (cars and furniture) for a total of $27,439. Debtors' projected monthly net income would repay 55.2% of non-priority unsecured debt over five years.

George Case #2 Husband, a senior lab scientist, and wife, a utility worker in a manufacturing company, have no dependents. Their income if $3,701. They owe $2,482 secured (mostly auto debt), $229 priority and $15,563 unsecured, $8,000 of which relates to a secured auto loan deficiency. The debtors initially filed a Chapter 13 case in October, 1991. That case was dismissed in December, 1994. They filed this Chapter 7 case in January, 1995. The debtors are homeowners and own a 1990 Nissan Sentra. They reaffirmed two unsecured debts, one for $28 and one for $687. Debtors' projected monthly net income would repay 25.5% of non-priority unsecured debt over five years.

Massachusetts

Massachusetts Case #1 The debtor, a single female with no dependents, is a customer service supervisor. Her income is $3,025. Her 1995 income was 5–10% less than 1994's. She owes $35,600 secured, $0 priority and $16,728 unsecured (mostly credit card and retail charges). She owns a mobile home and a 1994 Mitsubishi Galant. She reaffirmed a $23,449 debt secured by her mobile home. Debtor's projected monthly net income would repay 51.9% of non-priority unsecured debt over five years.

Page 570 PREV PAGE TOP OF DOC

Massachusetts Case #2 The debtor, a single male, has no dependents. He has been a construction inspector for 23 years. His income is $3,786. His debt is entirely unsecured credit card debt, totaling $44,109. He does not own a home. He owns two automobiles, a 1990 Blazer and a 1988 Jeep. Debtor's projected monthly net income would repay 38.3% of non-priority unsecured debt over five years.

Massachusetts Case #3 Husband works for a restaurant group and wife is also employed, although her occupation is not disclosed. Their income is $3,840. They have no dependents, and are not homeowners. Debtors own a 1991 Nissan Sentra. They owe $5,254 secured (car), $0 priority and $18,204 unsecured (mostly credit card debt). However, $2,200 of the unsecured debt is student loans. Debtors' projected monthly net income would repay 100% of non-priority unsecured debt over five years.

Massachusetts Case #4 The debtor, a single male senior engineer, has no dependents. His income is $5,103. He owes $2,185 secured, $0 priority and $44,127 unsecured. The unsecured debt is primarily credit card debt, but also includes $6,300 in student loans and a $7,200 promissory note to Fannie Mae. The debtor is not a homeowner. He leases a 1993 Honda Accord. Debtor's projected monthly net income would repay 100% of non-priority unsecured debt over five years. This case is one of the six can-pay cases where debtor would still be able to repay at least 20% of non-priority unsecured debt even if charitable contributions of 15% of gross income were made under the Tithing Act.

Massachusetts Case #5 Husband, a computer analyst and wife, a mechanical assembler, have an eight-year old grandson as a dependent. Their income is $6,131. Their 1995 income will be only 85% of their 1994 income. The debtors are not homeowners. They own a 1983 Toyota and a 1986 Lincoln Town car. They list no secured or priority debt. Their unsecured debt is $28,225, much of which is dischargeable federal tax debt from 1985–1990. Approximately $4,700 is student loans. The IRS garnished debtors' wages shortly before they filed their petition. Debtors' projected monthly net income would repay 100% of non-priority unsecured debt over five years.

Page 571 PREV PAGE TOP OF DOC

Nebraska

Nebraska Case #1 In this case, a married male debtor filed an individual petition. He is a garbage truck driver and his wife is a civilian employee at a military base. He lists no dependents. His income is $3,033. He and his wife moved from another state six months before he filed. They owe $0 secured, $3,500 priority taxes, and about $16,500 unsecured. He is not a homeowner and does not schedule a car, but lists a $556 monthly car payment. A car was repossessed in the past, but no recent collection activity is noted. Debtor's projected monthly net income would repay 75.1% of non-priority unsecured debt over five years.

Nebraska Case #2 Debtor, a single female with no dependents, has worked for a major national credit card processor for eight years. Her income is $3,196. She owes $8,642 secured, $0 priority and $13,880 unsecured. She is not a homeowner and owns a 1991 Honda Civic. Debtor reaffirmed the car debt ($4,468). Her major unsecured debt was co-signed by a male, relationship unknown. He sued her and obtained a $12,000 plus judgment. She was also sued on a medical bill. Debtor's projected monthly net income would repay 85.7% of non-priority unsecured debt over five years.

Nebraska Case #3 Husband, a railroad mechanic, and wife, a cook at a bar/grill, have a 14 year-old son. Their income is $3,400. Their annual income had declined from $52,300 in 1993 and $48,700 in 1994 to a projected $40,000 in 1995. They owe $8,000 secured, $0 priority, and $9,652 (mostly credit card and utilities from former home state). They are not homeowners. They own a 1993 Dodge Shadow, a 1986 Plymouth Horizon and a 1975 Honda 550. HFC sued the wife a year before the bankruptcy. Debtors reaffirmed four secured debts (car, tools and furniture) totaling $18,132. Debtors' projected monthly net income would repay 100% of non-priority unsecured debt over five years.

Page 572 PREV PAGE TOP OF DOC

Nebraska Case #4 Husband, a salesman, and wife, an office clerk, have a 19-year old son. Their income is $4,400. They owe no secured debt, $1,908 priority (taxes), and $57,860 unsecured. Most of the unsecured debt (other than a $3,600 student loan and $2135 in medical bills) is business debt from a failed restaurant formerly run by the debtors in another state. They are not homeowners. They own a 1989 Dodge van and 1978 Datsun pickup. They filed after one business creditor obtained a judgment against them. Debtors' projected monthly net income would repay 82.4% of non-priority unsecured debt over five years.

Nebraska Case #5 Husband, clerk for a school district, and wife, manager of a McDonald's restaurant, have four children aged 9 to 15. Their income is $4,748. They owe $6,000 secured, $0 priority and $46,014 unsecured. Nearly all of the unsecured debt is medical bills; less than $1,000 is credit card debt. The debtors are not homeowners. They own one car, a 1986 Dodge Caravan, which the debtors indicated they would surrender. They had filed a previous Chapter 7 in April 1990. They filed the current case in Chapter 13. In 1996, they converted to Chapter 7 as soon as they became eligible for a second Chapter 7 discharge. Debtors' projected monthly net income would repay 100% of non-priority unsecured debt over five years. This case is one of the six can-pay cases where debtors would still be able to repay at least 20% of non-priority unsecured debt even if charitable contributions of 15% of gross income were made under the Tithing Act.

Nebraska Case #6 Husband, a retiree and part-time maintenance man, and wife, a debt collector, have a nine-year old granddaughter as part of their household. Their income is $4,957, $1,000 of which is husband's retirement pay. They owe $23,458 secured, $0 priority and $48,673 unsecured. The debtors are not homeowners. They own a 1991 Thunderbird, a 1984 Thunderbird and a 1988 Grand Am. The debtors had not previously filed bankruptcy, but their file indicated their daughter was also in bankruptcy when they filed. Debtors' projected monthly net income would repay 64.2% of non-priority unsecured debt over five years.

Page 573 PREV PAGE TOP OF DOC

North Carolina

North Carolina Case #1 Husband, a mechanic, and wife, a clerk, had a combined income of $3,402 and a five-year old daughter. However, they also indicated that the wife was disabled and was expecting twins. It is unclear whether wife's stated income of $1,459 was historical or current information. We treated it as their current income. They owe $9,766 secured, $0 priority and $33,526 unsecured (all mobile home debt). They own a mobile home, a 1984 Dodge Daytona and a 1989 Hyundai. The debtors reaffirmed one unsecured debt for $478. Debtors' projected monthly net income would repay 20% of non-priority unsecured debt over five years.

North Carolina Case #2 The debtor, a single female systems analyst, has no dependents. Her income is $3,450. She owes $48,595 secured, $0 priority, and $3,516 unsecured. She does not own a home in North Carolina, but the stay was lifted to allow foreclosure on real estate in Massachusetts. She owns a 1983 Maxima and a 1984 300 ZX. She may have filed to forestall foreclosure. Debtor's projected monthly net income would repay 100% of non-priority unsecured debt over five years.

North Carolina Case #3 Husband is a truck driver and wife, although formerly employed, was out of work at time of filing. They list no dependents. Their income is $3,563, but state that income will drop due to an anticipated move. They owe $3,400 secured, $0 priority, and $26,618 unsecured, much of which is medical bills. They are not homeowners. They own a 1986 Chevrolet Spectrum. In August, 1992, a 1987 Hyundai was repossessed. In September, 1993, a 1977 Dodge Ram Charger was repossessed. Six other creditors recovered judgments within the year before they filed. Debtors reaffirmed a $3,400 car loan and an unsecured debt for $490. Debtors' projected monthly net income would repay 86.9% of non-priority unsecured debt over five years.

Page 574 PREV PAGE TOP OF DOC

North Carolina Case #4 Husband, an Air Force retireee, is disabled and wife is a textile worker in a towel factory. They have one dependent, a daughter. Debtors are separated and maintain two homes. Their income is $4,533, much of which is husband's retirement pay, VA and disability benefits. Their bankruptcy is a result of a failed flea market business. They owe $75,565 secured, $0 priority and $70,696 unsecured ($58,588 from a business premises lease for the flea market). They own a home, a 1992 Ford Mustang, a 1985 Ford truck and a 1988 Cadillac. Debtors reaffirmed two car loans totaling $17,631 and an unsecured debt for $549. Debtors' projected monthly net income would repay 68.7% of non-priority unsecured debt over five years.

North Carolina Case #5 Husband, a restaurant manager, and wife, a bank loan processor, have a 19-year old daughter. They are separated and maintain two households in different towns. Their income is $5,017. They owe $105,828 secured, $3,403 priority, and $39,171 unsecured (all credit card and retail charge card debt). They own a home as well as a 1992 Ford Tempo, 1991 Ford Probe and 1983 Toyota Celica. No collection activity is noted. Debtors' projected monthly net income would repay 100% of non-priority unsecured debt over five years. This case is one of the six can-pay cases where debtors would still be able to repay at least 20% of non-priority unsecured debt even if charitable contributions of 15% of gross income were made under the Tithing Act.

Wisconsin

Wisconsin Case #1 The debtor, a single male with no dependents, is semi-retired and works as a security guard. His income is $2,325. He owes $12,820 secured, $0 priority and $8,976 unsecured, of which $5,200 is owed to VISA and $3,700 is a deficiency due to repossession of his 1988 Chevy Corsica in August 1995. The debtor filed bankruptcy five weeks after the repossession. He is not a homeowner. He owns a 1993 Buick Regal. The debtor reaffirmed two debts secured by his Buick totaling $10,857. Debtor's projected monthly net income would repay 100% of non-priority unsecured debt over five years.

Page 575 PREV PAGE TOP OF DOC

Wisconsin Case #2 Debtor, a single male who has been a salesman for 28 years, has no dependents. His income is $3,414. He owes $33,101 secured, $0 priority and $87,817 unsecured. His unsecured debt consists principally of credit card obligations and a $33,000 loan from a relative, probably made to help the debtor cover gambling losses. The debtor owns a home and a 1987 Chevy Blazer. The debtor schedules gambling losses of $27,600 in the two years before bankruptcy. His monthly credit card payments are $1,166. The debtor reaffirmed five debts totaling $64,284, including unsecured debts of $33,258 (to the relative), and debts secured by his home, a boat and an insurance policy. Debtor's projected monthly net income would repay 32.4% of non-priority unsecured debt over five years.

Wisconsin Case #3 Husband, a research analyst for the state, and wife, a computer operator, have two children. Their income is $5,076. They owe $95,177 secured, $454 priority (tax debt) and $40,179 unsecured, $10,000 of which is student loans. They own a home, a 1993 Pontiac Trans Sport and a 1985 Pontiac Bonneville. No garnishments, attachments or repossessions are noted. The debtors reaffirmed a car loan for $11,688. Debtors' projected monthly net income would repay 75.1% of non-priority unsecured debt over five years.

Wisconsin Case #4 Husband, a teacher for 14 years, and wife, an assembler, pay child support for husband's three-year old. Their income is $5,424. Their secured debt is $11,735. They list $3,578 as a priority claim, but in fact this is a student loan debt. They also scheduled two tax claims, but listed the amounts as $0. Their unsecured debt is $9,975 (plus the student loan). The debtors are not homeowners. They have a 1984 Dodge Ram pickup and a 1989 Chevy van. They filed a previous bankruptcy in 1989. The 1995 filing followed soon after a law firm garnished husband's pay for an unsecured debt. He also has older debts for legal fees, probably arising from his divorce from the child's mother. Some medical and dental debts were incurred in 1994; however, $0 is allotted for monthly medical bills. The debtors reaffirmed three unsecured debts totaling $2,970 and a car loan for $8,344. Debtors' projected monthly net income would repay 57.2% of non-priority unsecured debt over five years.

Page 576 PREV PAGE TOP OF DOC

Wisconsin Case #5 In this asset case, husband is a superintendent of schools and wife is a college professor. Their income is $9,692. They scheduled no dependents, but they have children in college to whom they send $600 a month. Debtors have unusually high expenses because wife lives and works in another city during the week, while husband lives in the family home. They owe $146,297 secured, $7,133 priority and $104,325 unsecured. They own a home, a 1989 Oldsmobile Toronado and a 1994 Mercury Cougar. Much of their debt arose from a failed travel agency business. Debtors filed bankruptcy after a business creditor sued them. The case was still open and the trustee had not filed her report on distribution of assets when we copied this file. Debtors' projected monthly net income would repay 100% of non-priority unsecured debt over five years. This case is one of the six can-pay cases where debtors would still be able to repay at least 20% of non-priority unsecured debt even if charitable contributions of 15% of gross income were made under the Tithing Act.

APPENDIX B—OUR SAMPLE

Sample Design. Our sample is a stratified random sample of Chapter 7 cases, originally designed and collected, as noted above, for a study of reaffirmation practice underwritten by the National Conference of Bankruptcy Judges, the Bankruptcy Section of the Nebraska Bar Association and Creighton University.(see footnote 132) We intended in that project to see whether reaffirmation rates varied much among federal judicial districts and, if so, to test the effects of two variables on those rates. The variables were: first, the district's ratio of nonbusiness Chapter 7 to Chapter 13 filings, and second, the law of the district on retention of collateral without reaffirmation or redemption.(see footnote 133) To evaluate those inter-district differences, we needed a fair number of cases from each sample district. We settled on 150 cases from each of seven districts for a total of 1,050 cases.

Page 577 PREV PAGE TOP OF DOC

Circuits requiring reaffirmation or redemption: In re Burr, 160 F.3d 843 (1st Cir. 1998); In re Johnson, 89 F.3d 249, 250–52 (5th Cir. 1996); In re Taylor, 3 F.3d 1512, 1516–17 (11th Cir. 1993); and In re Edwards, 901 F.2d 1383, 1385–87 (7th Cir. 1990).

The districts sampled (and their circuits) are:

The Northern District of California (Ninth Circuit)
The District of Colorado (Tenth Circuit)
The Northern District of Georgia (Eleventh Circuit)
The District of Massachusetts (First Circuit)
The District of Nebraska (Eighth Circuit)
The Middle District of North Carolina (Fourth Circuit)
The Western District of Wisconsin (Seventh Circuit).

This gave us coast-to-coast coverage and a good mix of urban (Atlanta, Boston, Denver and San Francisco) and less-densely populated areas. Of particular importance for means-testing, these districts also cover the spectrum of high and low cost-of-living areas.

Building the Database. Once we had identified the districts and obtained the consent of the respective Chief Bankruptcy Judges and Bankruptcy Clerks, we asked each district for a list of all docket numbers assigned to bankruptcy cases filed anywhere within the district in calendar year 1995.(see footnote 134) Our statistician(see footnote 135) used those docket number lists to generate random number lists of about 400 cases for each district. We next used computerized bankruptcy court docket-access programs (BANCAP and PACER) to identify the first 150 cases on each list which met the sample's three qualifications:

Page 578 PREV PAGE TOP OF DOC

1) Filed as or converted to a Chapter 7 case;

2) Filed by an individual or a married couple; and
3) The file included most schedules in order to assure adequate useful data.

This process gave each qualified case, regardless of when and where filed even within multi-divisional districts, an equal chance to become part of the final sample.

Next, we arranged to photocopy the files and transport the copies to Creighton University School of Law for coding. We benefited greatly from outstanding cooperation from the personnel of the Bankruptcy Court Clerk's office in each district. They helped us track down files from all divisions and retrieve some from deep storage in federal archives as well. In addition, we are indebted to Professor Gary Neustadter of Santa Clara Law School, who handled the Northern District of California files. Only three files ultimately could not be located. For each of these, we substituted the next qualified case from the relevant district's random number list.

At Creighton Law School, data entry was done by Professor Marianne Culhane and five third-year law students under her direction. Our statistician and programmer designed an easy-to-use data entry program using Microsoft Access 2.0, and trained us and the students in its use. Each case was entered by one person, rechecked by another and all differences reconciled. Additional rechecks of student work were done by Marianne Culhane. While we originally aimed at and coded 150 cases from each district, we eventually eliminated seven cases as outliers. These seven cases each had total debt in excess (some well in excess) of $1 million, and they seemed likely to distort totals in a sample of this size. Two additional cases were eliminated for the Means-Testing Project because the debtors in those cases did not file Schedule I on income. Thus, the final sample is of 1,041 cases from seven districts.

Page 579 PREV PAGE TOP OF DOC

The Reaffirmation Database provides a wealth of data on each case. It was designed to include more information than needed for that project, in hopes we could adapt it for other uses, plus build a longitudinal database by adding cases from later years at regular intervals.

A partial list of data follows. Each asset, creditor and claim is separately coded and classified; collateral is linked to the relevant secured claim; and each intended action from the Statement of Intention is linked to the relevant claim, asset and reaffirmation agreement, if any. Some data from the Statement of Affairs (prior years' income, gambling losses, repossessions and foreclosures) as well as attorney fees from the Rule 2016b form are coded. Income and expense data from Schedules I and J are, of course, included. Since almost all the cases had been closed before we collected them, the files reflected and we took note of events well after the initial filing. We coded all amendments to the schedules, adversary proceedings and a variety of motions. In the few asset cases, we coded proofs of claims and trustee's reports on distributions of the estate.

Adapting the Database for Means-Testing. Despite this wealth of data, additional coding was necessary for the Means-Testing Project. From Schedule I, for example, we had originally recorded marital status, number and relationship of dependents, job title, employer, length of employment, gross and net income from employment, incoming alimony/support and total monthly income. For means-testing, however, we needed more detail on payroll deductions. For debtors who passed the median income test,(see footnote 136) we went back to the hard copies of the files to code the amount and type (tax, social security, insurance, retirement account contribution, union dues, debt repayment, alimony/support) of each deduction, so that these could be appropriately allowed or disallowed for H.R. 3150's Projected Monthly Net Income test. We added more detail from Schedule J, Debtor's Monthly Expenses. Here we had originally coded expenses such as mortgage/rent, medical, outgoing alimony/support, regular business expenses, installment payments and total monthly expenses. For means-testing, we added charitable contributions, insurance, taxes, and child care, and for homeowners, utilities, property taxes, homeowner's insurance and home maintenance expenses.

Page 580 PREV PAGE TOP OF DOC

Tables 8, 9 and 10 below give a picture of the mean and median debt levels, in 1995 dollars, of all the debtors in the sample used for the Means-Testing Project.

Table 8

Table 9

Table 10

Mr. **GEKAS.** Thank you.

Ms. Ryu.

STATEMENT OF LISA H. RYU, STAFF ECONOMIST, THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS, WASHINGTON, DC

Ms. **RYU.** Good afternoon, Mr. Chairman and members of the committee. My name is Lisa Ryu. I am an economist for the National Association of Federal Credit Unions. NAFCU and the entire credit union community appreciates this opportunity to participate in today's hearing.

As nonprofit financial cooperatives, credit unions face unique problems associated with rising bankruptcies. In 1998, nearly 250,000 credit union members with $1 billion in outstanding loans filed for bankruptcies. The growing number of credit union member bankruptcies adds an extra burden on credit unions; because of their nonprofit cooperative characteristics, the cost of the bankruptcies is directly borne by all members.

Page 581 PREV PAGE TOP OF DOC

When a few high-income member-debtors are permitted to file for chapter 7 bankruptcies, the system in fact subsidizes these debtors at an expense of financially responsible credit union members of modest means.

With the means-testing provision of H.R. 833, bankruptcy can regain once again its role as the last resort for debtors in dire financial needs. While most agree that means testing is likely to have an impact on chapter 7 petitioners, the degree of this impact is widely debated. Two major empirical studies concerning means testing, the Ernst & Young report and the Culhane and White report, yield two conflicting results. In contrast to the Ernst & Young study, which found that 15 percent of all chapter 7 petitioners would be affected by the means testing, Culhane and White concluded that the impact would be limited to 3 percent of chapter 7 petitioners.

The conflicting results reported in Ernst & Young and Culhane and White are baffling, since at least at the surface Culhane and White seemed to have emulated a methodology used earlier by Ernst & Young. However, a closer evaluation of the Culhane and White report reveals methodological and interpretive biases that were not present in the Ernst & Young study. These biases were introduced throughout various stages of the study. Because of these biases, the findings of Culhane and White should be taken with utmost caution.

Upon analyzing both studies, I have come to the conclusion that the prediction of Ernst & Young is likely to be too high while the Culhane and White estimates were too low. It is my opinion that 10 percent of current chapter 7 debtors would be moved to chapter 13. While on its face 10 percent does not sound like a major portion of chapter 7 debtors, however, it is important to look at this number from an economic perspective. If 10 percent of current chapter 7 debtors file under chapter 13 and repay 60 percent of their total debts over a 5-year period, nearly $14 billion of outstanding debts held by impacted debtors would be repaid to creditors over the next 5 years.

Page 582 PREV PAGE TOP OF DOC

Approximately $6.1 billion of this repayment is for unsecured nonpriority debts that would be discharged if these debtors filed for chapter 7. Even taking 3 percent of the result of the Culhane and White report at face value, the estimated amount of this repayment resulting from the means test during the next 5 years would be $4.7 billion, 16 times larger than the projected cost by the Congressional Budget Office. Forty-three percent of this repayment or $2 billion is a repayment on the otherwise noncollectible portion of the unsecured nonpriority debt.

Now let me turn to the costs of implementing the means test. According to the CBO estimate of the Consumer Bankruptcy Reform Act of 1998, H.R. 3150, as reported by the Senate Committee on the Judiciary last year, is expected to cost the Federal Government $293 million over a 5-year period. This figure, however, does not incorporate cost savings from the long-term impact of means testing. Fifty percent of this projected cost or $152 million is associated with debtor financial management training. The long-term impact of this training is likely to be a reduction in total bankruptcy filings in coming years, which in turn will reduce the court costs of bankruptcy.

In addition, the number of judges overseeing bankruptcy proceedings are expected to rise even without means testing if the current level of increase in bankruptcy filings continues in coming years. Therefore, the projected costs related to additional judgeships and support, which was $57 million in total over the 5 year period, are likely to be somewhat overestimated.

Mr. Chairman, NAFCU applauds your efforts and those of the committee members to reform the bankruptcy system. I appreciate the opportunity to appear before you today and I will be happy to answer any questions.

Page 583 PREV PAGE TOP OF DOC

[The prepared statement of Ms. Ryu follows:]

PREPARED STATEMENT OF LISA H. RYU, STAFF ECONOMIST, THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS, WASHINGTON, DC

INTRODUCTION

The National Association of Federal Credit Unions (NAFCU) is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of approximately 1,100 federal credit unions—financial cooperatives from across the nation—that collectively hold approximately 70 percent of total federal credit union assets; NAFCU represents the interests of approximately 25 million individual credit union members. NAFCU and the entire credit union community appreciates this opportunity to participate in the discussion regarding the need for reform of the nation's bankruptcy system.

NATURE OF CREDIT UNIONS

Historically, credit unions have served a unique function in the delivery of financial services to people of modest means. Every credit union is, by statute and practice, a cooperative association organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." [12 USC 1752(1)] While more than 60 years have passed since the Federal Credit Union Act was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as they were when Congress first authorized the establishment of federal credit unions:

Page 584 PREV PAGE TOP OF DOC

First, credit unions remain totally committed to providing their members with efficient, low-cost personal service.

Second, credit unions continue to emphasize traditional cooperative values, such as democracy and volunteerism.

As owners of not-for-profit, cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—regardless of the amount they have on account at the credit union. These singular rights extend all the way from making basic operating decisions to electing the board of directors. Unlike banks and thrifts, federal credit union directors, motivated by an altruistic desire to be of service to others, serve without remuneration—a fact that epitomizes the true "volunteer spirit" which permeates the credit union community.

Credit unions play an important role in the financial lives of more than 70 million Americans from all walks of life who have chosen the convenient and low-cost financial services that only credit unions can provide. As the package of services offered by various types of financial institutions becomes more and more homogenized, the emphasis shifts from the type of service offered to the quality and cost of service provided. Historically, credit unions have been second to none in providing their members with quality personalized service at the lowest possible cost. According to an annual survey conducted by the *American Banker* newspaper, 1997 was the thirteenth consecutive year in which credit unions have rated higher than all other financial institutions in overall service quality and this trend shows no sign of change.

Page 585 PREV PAGE TOP OF DOC

NEED FOR BANKRUPTCY REFORM

The number of consumers filing for bankruptcy rose dramatically in 1998. From 1993 to 1997, there was an average of 989,000 personal bankruptcy filings a year. In 1998 there were over 1,400,000 personal bankruptcy filings. This marks a new record in the number of bankruptcy filings. This upward trend in consumer bankruptcy filing is expected to continue in 1999.

Unfortunately, a small but growing number of consumers are not financially responsible and abuse the bankruptcy system at a high cost to the consumers and the national economy. The credit union community feels strongly that bankruptcy reform is needed to encourage financial responsibility for debtors and for those creditors who would mislead or take advantage of consumers. The bankruptcy reform issue is not an issue of balancing the pursuits of debtors with the interests of creditors. It is simply an issue of financial responsibility versus financial irresponsibility.

The credit union community does not oppose bankruptcy relief for those persons who have a bona fide need for relief. Instead, the concern is with those consumers who use bankruptcy as a financial planning tool and those who turn to bankruptcy as the "easy way out."

CREDIT UNION RESPONSE TO CONSUMER BANKRUPTCY

Most credit unions have lower operating margins than other types of lenders. Typically, credit unions pay higher rates on savings and charge lower rates on loans than other financial institutions. Because of these smaller margins, credit unions are hit harder than other financial institutions by escalating bankruptcy costs. A natural reaction for some institutions is to increase interest rates, but that is not what credit unions do. Credit unions keep interest rates as low as possible for the benefit of their members.

Page 586 PREV PAGE TOP OF DOC

Credit unions do much to promote financial responsibility among their members. Because credit union members pool their resources for the mutual benefit of all members, they have traditionally relied heavily on member education and individual counseling to encourage and promote financial responsibility. An example of this emphasis on credit unions' consumer education efforts is Navy Federal Credit Union. Navy FCU trains its employees in financial counseling, check book balancing and family budgeting. They advise members on the merits of saving and the consequences of heavy debt loads. Member articles are published and brochures are provided for members to assist in making responsible financial decisions.

REFORM EFFORTS: CREDIT UNION PERSPECTIVE

Because of the rising number of personal bankruptcy filings, the credit union community believes that legislative action is necessary to improve the current bankruptcy system. To support Congress in that effort, NAFCU established an ad hoc Bankruptcy Committee in 1997. After extensive study and bolstered with the input of a nationwide survey of credit unions, NAFCU's ad hoc Bankruptcy Committee approved a formal "Proposal to Improve the Bankruptcy System" (see Appendix 1). The product is a genuine effort to improve our nation's bankruptcy laws and procedures.

To better understand how the nation's credit unions are affected by bankruptcy, NAFCU's ad hoc Bankruptcy Committee surveyed over 1,050 federally chartered credit unions. In the survey three issues seem to move to the forefront of the credit union agenda with regards to bankruptcy.

Page 587 PREV PAGE TOP OF DOC

First is *requiring Chapter 13 consideration before establishing eligibility for Chapter 7*. Bankruptcy courts do not require any showing of need or minimum level of debt. The bankruptcy court simply accepts the debtor's assertion that bankruptcy is necessary. As a result, Chapter 7 often gives more relief than is necessary. The full discharge of debts provided by Chapter 7 is a carryover form the last century, when most credit was secured by tangible assets. Today's consumer-based economy is built on unsecured revolving credit with the promise that debtors will pay from future income. Approximately 97 percent of the respondents support a bankruptcy system that is needs-based. This would help to increase debtor accountability, create a fairer bankruptcy system, and more fairly distribute payments among all creditors.

Second is *mandatory financial education for all bankruptcy filers*. Credit unions have a long history of educating their members in financial matters. The wise use of credit as well as the value of systematic savings are basic credit union principles. Most credit unions attempt to provide the best possible education for their members. Of those surveyed 84 percent support a requirement that would require debtors to participate in credit counseling before filing bankruptcy.

Third is *strengthening the right of reaffirmation for credit union members*. Credit unions traditionally have higher reaffirmation rates than many other lenders, partly because their members realize that credit unions offer them low interest rates on loans and high dividend rates on savings. The higher credit union reaffirmation rates reflect other characteristics of the credit union philosophy such as the knowledge that fellow credit union members will bear the costs of any debt discharged in bankruptcy. Credit unions believe that their members should be assured that they can retain their relationship with their financial institutions by reaffirming loans at reasonable rates, rather than being forced to pay higher prices elsewhere. 76 percent of those surveyed believe that the bankruptcy code should not include any limitations on the right to reaffirm, but support requirements that would make sure debtors were fully informed about reaffirmation agreements and corresponding responsibilities.

Page 588 PREV PAGE TOP OF DOC

Reflected in NAFCU's proposal, credit unions throughout the country advocate meaningful reform of the bankruptcy system. NAFCU's proposal include recommendations that:

The Bankruptcy Code should require that debtors who are able to pay a portion of their debts file a repayment plan under Chapter 13;

The Code should establish uniform rules and procedures for processing creditors' claims and payments;

The Code should establish uniform federal exemptions;

Debtors should be required to complete a basic financial education course prior to receiving discharge;

A debtor should be required to notify secured creditors, within ten days of filing bankruptcy, whether the debtor intends to surrender, redeem, or reaffirm the collateral; and,

For creditors seeking to recover collateral, the automatic stay should expire at the end of the notification period.

NAFCU also recommends establishing a Bankruptcy Advisory Council, which includes debtor and creditor representatives. The council should be charged with studying bankruptcy and bankruptcy reform. This council could be established under the auspices of the U.S. Department of Justice. Alternatively, the Federal Reserve Board's existing Consumer Advisory Council should be required to submit an annual report to Congress on bankruptcy and bankruptcy reform.

Page 589 PREV PAGE TOP OF DOC

REFORM EFFORTS: CONGRESSIONAL ACTION

Despite all of the efforts to educate, to make sound loans, and to assist those in trouble, bankruptcy reform is needed *and is needed now* to encourage financial responsibility. The needs-based approach of H.R. 833, the *Bankruptcy Reform Act of 1999*, introduced by Representatives George Gekas, Rick Boucher, Bill McCollum and Jim Moran, is a positive step towards helping to ensure more responsibility. H.R. 833 would make a number of changes to U.S. bankruptcy law in an effort to prevent fraudulent bankruptcies and increase the likelihood that bankruptcy filers will repay their debts. NAFCU supports H.R. 833.

NAFCU agrees with the needs-based approach of H.R, 833. This would help in determining the correct amount of financial relief necessary. The *Debtor's Bill of Rights* provision in H.R. 833 should provide protection for debtors from "bankruptcy mills"—law firms and other groups that steer consumers to bankruptcy. Other provisions of the *Bankruptcy Reform Act of 1999* that will aid bankruptcy reform include: the creation of a consumer education program, debtor notification, and developing a national database.

REFORM EFFORTS: THE MEANS-TEST

When the *Bankruptcy Reform Act of 1998*, H.R. 3150, was introduced in the 105th Congress, the means-test provision of the bill was questioned. The means-test provisions sparked many different opinions and studies. H.R. 833 retains the means-test provision of H.R. 3150.

Page 590 PREV PAGE TOP OF DOC

The test takes a debtor's individual circumstances into account while at the same time ensuring that those who can afford to repay some of their debt are required to do so. The test included in H.R. 833 works only if a Chapter 7 filer earns more than the national median income and can afford to pay back either $5,000 or 25 percent of his or her debt over five years. If that is the case, a judge may convert the filing to a Chapter 13 bankruptcy or dismiss the case all together. The judge may take any extraordinary circumstances into account, such as a decline in income, divorce, or unexpected medical expenses.

NAFCU believes the means-test is necessary and it is a fair test to afford bankruptcy to those who are in need. In a period of unprecedented economic prosperity in the United States, the fact that non-business bankruptcy filings continue to rise has left many observers bewildered. In spite of low unemployment, stable prices and rising personal income, non-business bankruptcy filings have increased by 79 percent since 1994. This increase can be mainly attributed to a dramatic increase in Chapter 7 bankruptcy filings. With over 1 million petitions, total chapter 7 bankruptcies filed by individuals in 1998 was 60 percent higher than the average filings during the recessions of 1990 and 1991.(see footnote 137) If non-business Chapter 7 filings increase at the same rate as the last five-year's average, the total number of Chapter 7 petitions are expected to reach 2.3 million by 2003.(see footnote 138) Chapter 7 bankruptcy filings as a percentage of total non-business filings have increased steadily in recent years. In 1998, over 72 percent of non-business bankruptcy filings were Chapter 7 petitions. While personal factors such as divorce and medical problems are often cited as underlying causes of many personal bankruptcies, these factors do not seem to explain the sharp rise in personal bankruptcies during the 1990s.

As non-profit financial cooperatives, credit unions face unique problems associated with rising bankruptcies. As of December 1998, about half of all federally insured credit unions (5,497 credit unions) have assets less than $6.2 million. As with many other financial institutions, bankruptcy is a major problem for credit unions. In 1998 alone, nearly 250,000 credit union members with $1 billion in outstanding loans filed for bankruptcies.(see footnote 139) On average, nearly half of all loan losses at federally insured credit unions in 1998 was due to bankruptcy. Bankruptcy accounted for more than 70 percent of all charge-offs among 27 percent of all credit unions. The growing number of credit union member bankruptcies adds an extra burden on credit unions; because of their non-profit cooperative characteristics, the cost of the bankruptcies is directly born by all members. When a few high-income member-debtors are permitted to file for chapter 7 bankruptcies, the system, in fact, subsidizes these debtors at an expense of financially responsible credit union members with modest means. For instance, according to Navy Federal Credit Union, if there were no bankruptcy losses, the interest rate on Navy Federal's VISA Classic credit card could be 1.3 percentage points lower than the current rate.(see footnote 140)

Page 591 PREV PAGE TOP OF DOC

The means-testing provision is one of the most important components of the proposed bankruptcy reform legislation. By requiring high-income debtors to file under Chapter 13 rather than Chapter 7, means-testing attempts to remedy the increasingly regressive nature of the current bankruptcy proceedings by raising the transaction cost of Chapter 7 bankruptcy filings for high-income debtors. Overall, the means-testing provision achieves two broad effects. First, by requiring high-income debtors to repay at least a portion of their debt, the provision reduces the social and economic costs of irresponsible financial management and abuse of the current bankruptcy system by wealthy debtors. Second, means-testing is anticipated to have a longer-term benefit as it deters fraudulent bankruptcy filings.

With the means-testing provision, bankruptcy can regain once again its role as the last resort for debtors in dire financial needs. According to the Congressional Budget Office (CBO), the total number of bankruptcies is expected to drop 5 percent immediately upon the enactment of the proposed bankruptcy reform that includes the means-testing provision.(see footnote 141)

While most agree that means-testing is likely to have an impact on Chapter 7 petitioners, the degree of this impact is widely debated. Two major empirical studies concerning means-testing, the Ernst & Young report(see footnote 142) and the Culhane and White report,(see footnote 143) yield two conflicting results. In contrast to the Ernst & Young report which found that 15 percent of all Chapter 7 petitioners would be affected by the means-testing, Culhane and White concluded that the impact would be limited to 3 percent of Chapter 7 petitioners. The findings of Ernst & Young confirmed both the results of a previous Ernst & Young study using four sample districts and other studies concluding that a significant portion of Chapter 7 petitioners would be affected by the provision.(see footnote 144)

Page 592 PREV PAGE TOP OF DOC

The conflicting results reported in the Ernst & Young report and the Culhane and White report are baffling since, at least at the surface, the Culhane and White report seemed to have emulated the methodology used earlier by Ernst & Young. Some of the assumptions questioned by the General Accounting Office (GAO)(see footnote 145) in its evaluation of the Ernst & Young report were also maintained by the Culhane and White report with the exemption of the incorporation of administrative expenses. The minor differences in assumptions are not likely to have any significant impact on the results. However, a closer evaluation of the Culhane and White report reveals methodological and interpretive biases that were not present in the Ernst & Young study. A discretionary interpretation of the language of the proposed bill, combined with the manner of sample selection and presentation, are factors that introduced biases to the data analysis.

Appendix 7 summarizes the major differences between the two reports. Because the income criteria for means-testing was raised from 75 percent to 100 percent of the median national income adjusted for family size since the publication of the Ernst & Young study, part of the difference between the results of two studies reflects this change in the income criteria. However, as illustrated in Appendix 7, there are other major methodological differences between the two studies, and these differences can lead to divergent results. First, the sample years of the two studies are different. While the Ernst & Young report analyzed Chapter 7 personal bankruptcies filed in 1997, the more recent Culhane and White report examined 1995 filings. The previous work by Ernst & Young(see footnote 146) using Chapter 7 filings during the 1992–1993 period found that a smaller percentage of debtors would be impacted by the provision. Based upon these findings, the sample year of the study clearly has relevance to the study's results.

Page 593 PREV PAGE TOP OF DOC

Second, while the Ernst & Young report drew its sample from all 90 district courts in the nation, the Culhane and White report selected samples from only seven sample districts. These districts were the Northern District of California, the District of Colorado, the Northern District of Georgia, the District of Massachusetts, the District of Nebraska, the Middle District of North Carolina and the Western District of Wisconsin. According to the Culhane and White report, these districts were chosen to represent "coast-to-coast coverage and a good mix of urban (Atlanta, Boston, Denver, and the Bay Area) and less densely populated areas" as well as "the spectrum of high and low cost-of-living areas."(see footnote 147) The selection of these districts was, however, highly subjective as it did not follow a statistically sound random sampling process. Therefore, it is difficult to ascertain with any degree of statistical confidence how well the individual characteristics and behavior of Chapter 7 filers in these districts represent all Chapter 7 filers.

While Culhane and White selected the sample districts with specific criteria in mind, it failed to recognize the differences in regional macroeconomic circumstances and legal practices among these districts in its statistical analysis. Other studies of personal bankruptcy have found a substantial variation in bankruptcy practices and the debtor's ability to repay across the states.(see footnote 148) Recognizing this variance, GAO questioned the inference of national statistics using the findings of sample districts not selected by a statistically random method in its analysis of a Credit Research Center's report on debtors' ability to pay.(see footnote 149)

The GAO stated that:

Page 594 PREV PAGE TOP OF DOC

[. . .] the Center report presented results based on data from all 13 locations combined. However, the data provided to us by the report's authors, but not included in the report, showed *wide variation among the report's 13 locations in debtors' estimated ability to pay. [. . .] These variations may in part reflect the influence of varying local bankruptcy practices.*(see footnote 150) Given these variations, we believe it is appropriate to be cautious in making general statements about the debtors across all 13 locations.(see footnote 151) *(italics added)*

Third, even though both studies used a two-step sampling technique, there were substantial methodological differences in the sample selection process. Ernst & Young selected a stratified random sample of approximately 500 non-business Chapter 7 petitions from 90 district courts (43,730 cases), which were later reduced to 2,142 cases using self-weighted random sampling process reflecting monthly total Chapter 7 petitions per district. As a result of this random sampling process, the number of petitions per district included in the sample is representative of the total population of Chapter 7 filers. Additionally, Ernst & Young have over-sampled asset-case Chapter 7 petitions to derive a statistically significant sample size of asset-case Chapter 7 petitions. Ernst & Young took extra steps to ensure that the final sample was statistically unbiased. These steps included an adjustment of sample totals as a proportion to the population to reduce coverage and non-response bias and variance effects. Due to this statistically random sampling process, the Ernst & Young report was able to use a statistical technique for determining the accuracy of their findings. At a 95 percent confidence level, the percentage of Chapter 7 filers impacted by means-testing would fall between 13.1 percent and 16.9 percent.

Page 595 PREV PAGE TOP OF DOC

In comparison, the sample selection process used by the Culhane and White study is not based on a statistically random method and it is likely to introduce a substantial degree of sampling bias. As a first step, the study selected a stratified random list of 400 docket numbers from seven district courts. However, unlike Ernst & Young, the list included Chapter 7 and Chapter 13 filings as well as both business and non-business filings. The second step selected the first 150 cases on each district list that were non-business Chapter 7 cases with adequate information to "assure adequate and useful data." Unfortunately, this was not a statistically random selection process and, therefore, significant bias was likely to be introduced during the sampling process. In addition, because the final sample is composed of an equal number of cases from each of seven districts in spite of the difference in the probability of filing for Chapter 7, the sample bears no resemblance to the population of Chapter 7 petitioners. Appendix 9 illustrates the magnitude of the authors' misrepresentation of the population of Chapter 7 petitions per district.

The sampling bias observed in the Culhane and White report resembles the GAO findings on the Credit Research Center report on debtors' ability to pay even though the two studies are very much different in many other aspects. GAO questioned the Center's sample selection method by stating that:

[. . .] the center's researchers selected the 13 bankruptcy locations and 3,798 personal bankruptcy petitions without using scientific random sampling techniques. As a result, *the national estimates presented in the report are not based on representative probability sampling methods. In addition, standard statistical methods, such as the calculation of statistical error rates, cannot be used to evaluate the likely accuracy of the results in the Center report*. Consequently, the methods used in the Center's analysis do not provide a sound basis for generalizing the Center report's findings to the annual 1996 filings in each of the 13 locations nor to the national population of personal bankruptcy filings.(see footnote 152) *(italics added)*

Page 596 PREV PAGE TOP OF DOC

Another concern about the final sample of Culhane and White is that it eliminated seven cases as outliers because of a high level of total debts reported by these debtors. According to Culhane and White, because these seven cases each had total debt in excess of $1 million, "they seemed likely to distort totals" in a sample of its size. However, this subjective decision on the authors' part has no credible statistical explanation. Since they used the "median" rather than the mean for the income and debt level assessment of the sample, the inclusion of these cases would not distort the result if the sample were indeed selected in a statistically random fashion.(see footnote 153) Even in a case like the Culhane and White study where a strict statistically random sampling method was not used, the exclusion of any selected sample is highly undesirable because the exclusion of these cases can lead to a significant bias in the result. For a statistical analysis to be dependable, researchers cannot exclude certain cases just because they do not like what they see. It must also be noted that these types of debtors with exceptionally high amount of debts are most likely to be wealthy individuals who are exactly the types of debtors for which the means-testing provision is intended. Thus, the exclusion of these cases is likely to lead to an underestimation of the impact of the means-testing.

Finally, Culhane and White interpreted the language of the 1997–1998 legislation somewhat differently from Ernst & Young. For one, they added ownership allowance (net of payment on an automobile loan) to all automobile owners regardless of the existence of automobile debt payment. For instance, a Chapter 7 bankruptcy petitioner who owns an automobile with no outstanding debt at filing is given $20,100 in ownership allowance to reflect leasing and replacement cost in the study. The assumption that an individual who cannot pay his or her existing debts should be expected to incur additional debt to purchase a new car as a replacement of an aging one is an unreasonable assumption. Also, the bankruptcy reform legislation specifies that monthly living expenses are to be derived using allowances under the applicable "National Standards, Local Standards and Other Necessary Expenses" allowance issued by the Internal Revenue Service (IRS). Collection Financial Standards (CFS) of the IRS sets a specific guideline regarding allowance for transportation expenses that states:

Page 597 PREV PAGE TOP OF DOC

If a taxpayer has a car payment, the allowable ownership cost added to the allowable transportation expense. *If a taxpayer has no car payment, or no car, only the operating cost portion of the transportation standard is used to come* *up with the allowable transportation expense*.(see footnote 154) *(italics added)*

Therefore, Culhane and White are likely to have substantially overstated the amount of transportation expenses, and thus, underestimated the debtor's ability to repay.

Another difference between the Ernst & Young report and the Culhane and White report is their treatment of administrative expenses. While the Ernst & Young report did not take administrative expenses into consideration in its analysis, the Culhane and White report subtracted administrative expenses—Chapter 13 trustee's fees and attorney expenses—from net income. While these administrative expenses are considered to be priority claims under section §507(a) of current bankruptcy code, their inclusion in the determination of the ability to repay is a matter of some debate. Jones and Zywicki,(see footnote 155) for instance, states that "trustees' fees are irrelevant to the debtor's ability to *pay*—although they are relevant to the creditors' ability to *collect*." The matter is, however, largely an issue of legal interpretation that should be resolved in the subsequent discussion.

The methodological and interpretative biases present in the Culhane and White report are likely to have resulted in significant underestimation of the Chapter 7 debtors' ability to repay. According to the later recalculation by Culhane and White, correcting for transportation expenses alone can increase the percentage of Chapter 7 filers impacted by the means-testing to 6.5 percent. If corrected for income and other biases as well as transportation expenses, the percentage of filers impacted by the means-testing is more likely to be close to 10 percent.(see footnote 156) This estimate is, in fact, close to the CBO projection. The CBO projected that as a result of the bankruptcy reform, "about 5 percent of all chapter 7 debtors would not file for any type of bankruptcy protection and that about 5 percent of all chapter 7 cases would be filed as or converted to chapter 13 cases."(see footnote 157) Even using a conservative estimate,(see footnote 158) these debtors who would be impacted by the means-testing currently hold $7.5 billion in total debt. In other words, every year financially responsible U.S. consumers are forced to provide $7.5 billion in financial subsidy to these high-income debtors. Under the current system of U.S. bankruptcy filings, which can be viewed as a regressive form of taxation, low-income households are those who bear the heaviest burden of this subsidy due to the credit reallocation and higher interest rates.

Page 598 PREV PAGE TOP OF DOC

According to the CBO estimate, the *Consumer Bankruptcy Reform Act of 1998*, H.R. 3150, as reported by the Senate Committee on the Judiciary on June 4, 1998 is expected to cost the federal government $293 million over a five-year period. This figure, however, does not incorporate cost savings from the long-term impact of means-testing. Fifty percent of this projected cost or $152 million is associated with debtor financial management training. The long-term impact of this training is likely to be a reduction in total bankruptcy filings in coming years, which, in turn, will reduce the court cost of bankruptcy. In addition, number of judges overseeing bankruptcy proceedings are expected to rise even without means-testing if the current level of increase in bankruptcy filings continues in coming years. Therefore, the projected costs related to additional judgeships and support ($57 million in total over the five-year period) pertaining to means-testing are likely to be somewhat overestimated.

If 10 percent of current Chapter 7 debtors file under Chapter 13 and repay 60 percent of their total debts over the five-year period, nearly $14 billion of outstanding debts held by impacted debtors would be repaid to creditors. Approximately $6.1 billion of this repayment is for unsecured nonpriority debts that would be discharged if these debtors filed for Chapter 7 bankruptcy.(see footnote 159) Even taking the results of the Culhane and White report at face value, the estimated amount of repayment resulting from the means-test during the next five years will be *$4.7 billion, 16 times larger than the projected cost*. Forty three percent of this repayment or $2 billion is a repayment on the otherwise non-collectible portion of the unsecured nonpriority debt.(see footnote 160) Some of the other economic benefits, although they are likely to be substantial, are not easily quantifiable prior to the actual implementation of the legislation. Some expected benefits include lower loan rates and greater credit availability to lower-income households as the financial benefit of the means-testing is reallocated to a more productive use. Particularly for credit unions, because of their nonprofit cooperative nature, these types of expected future benefits will be distributed directly to their members.

Page 599 PREV PAGE TOP OF DOC

CONCLUSION

Even before the National Bankruptcy Commission released its findings to Congress in October 1997, the need for overhaul of the nation's troubled bankruptcy system was evident. As bankruptcy filings increase, the burden on financial institutions also increases—a burden that ultimately is shouldered by the American consumer. NAFCU recognizes the need for reform and is grateful that Congress is focused on the problem and is determined to implement reforms.

To that end, NAFCU supports the *Bankruptcy Reform Act of 1999*. NAFCU believes that the means-test incorporated within H.R. 833 is the most effective way to deal with the rising bankruptcy filings, it will ensure that the system is fair for debtors, creditors and consumers. Credit unions take great pride in working with their members who encounter financial difficulties and this legislation is certainly a step in the right direction.

On behalf of NAFCU, thank you for considering the credit union perspective. NAFCU applauds the efforts of the Committee and hopes to continue to work with you to resolve this and other challenging issues.

APPENDIX 1.

NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

PROPOSAL TO IMPROVE THE BANKRUPTCY SYSTEM

Page 600 PREV PAGE TOP OF DOC

EXECUTIVE SUMMARY—JANUARY 1999

Overview:

The costs of bankruptcy losses are borne by consumers as a group through increased loan rates, stricter lending standards, and decreased dividend rates on savings. This situation clearly points to the need for substantive bankruptcy reform which encourages personal responsibility for both debtors and creditors. On October 20, 1997, the National Bankruptcy Review Commission (NBRC) submitted a report to Congress, the President and the Supreme Court which recommended changes to the Bankruptcy Code.

Highlights:

NAFCU strongly believes that the recommendations contained in the NBRC report greatly increase the rights of debtors without regard to the rights of creditors and the effects on consumers.

NAFCU opposes the NBRC's recommendation to prohibit reaffirmation of unsecured loans and severely limit reaffirmation of secured loans.

NAFCU opposes the unnecessary and burdensome valuation hearings proposed by the NBRC.

NAFCU is disappointed that the NBRC only recommends that debtors have an "opportunity" to participate in financial education programs.

Page 601 PREV PAGE TOP OF DOC

NAFCU believes the NBRC's valuation methods generally favor unsecured creditors and debtors to the detriment of secured creditors.

NAFCU views the Commission's exemption levels to be overly generous to debtors.

NAFCU opposes the modification of second mortgages secured by a debtor's principal residence.

NAFCU advocates meaningful reform of the bankruptcy system which balances the needs of creditors and consumers, including debtors.

The Bankruptcy Code (Code) should require that debtors who are able to pay a portion of their debts file a Chapter 13 (repayment) bankruptcy.

The Code should establish uniform rules and procedures for processing creditor's claims and payments.

The Code should establish uniform federal exemptions, ranging from $15,000 to $30,000.

Debtors should be required to complete a financial education course prior to receiving a discharge.

A debtor should be required to notify secured creditors, within 10 days of filing bankruptcy, whether the debtor intends to surrender, redeem, or reaffirm the collateral.

Page 602 PREV PAGE TOP OF DOC

For creditors seeking to recover collateral, the automatic stay should expire at the end of the notification period.

The Code should clarify the right of debtors to reaffirm both secured and unsecured debts.

NAFCU recommends establishing a Bankruptcy Advisory Council, which includes debtor and creditor representatives.

The Council should be charged with studying bankruptcy and bankruptcy reform.

Alternatively, the Federal Reserve Board's existing Consumer Advisory Council should be required to submit an annual report to Congress on bankruptcy and bankruptcy reform.

Table 11

Table 12

63593z.eps

63593aa.eps

63593ab.eps

Table 13

Table 14

Table 15

63593ac.eps

Mr. **GEKAS.** We thank the lady, and turn to the next witness.

Page 603 PREV PAGE TOP OF DOC

STATEMENT OF THOMAS S. NEUBIG, ERNST & YOUNG LLP, WASHINGTON, DC

Mr. **NEUBIG.** Mr. Chairman and members of the subcommittee, I appreciate the opportunity to present the findings of a new Ernst & Young study on chapter 7 filers' ability to repay under H.R. 833. I have included a copy of the report as an attachment.

Mr. **NADLER.** This is a new study, not the one from last year?

Mr. **NEUBIG.** Last year we studied H.R. 3150, and there is new legislation which has been introduced and we are studying H.R. 833.

Mr. **NADLER.** So when Professor Culhane was referring to her critique of the Ernst & Young study, she was talking about last year's study?

Mr. **NEUBIG.** I believe so, yes.

Mr. **NADLER.** Thank you.

Mr. **NEUBIG.** The General Accounting Office and others have characterized the lack of a nationally representative sample as a significant limitation of other studies of personal bankruptcy. That limitation does not apply to the Ernst & Young study, which is based on a nationally representative study of chapter 7 bankruptcy petitions. Thus, we are able to evaluate what effect the needs-based provision of H.R. 833 would have had on chapter 7 filers in 1997. We did not quantify the effects of other provisions of H.R. 833 which are also designed to reduce bankruptcy losses.

Page 604 PREV PAGE TOP OF DOC

The database upon which this study is based is the only statistically reliable national bankruptcy database ever created. This database is extensive, with over 2,100 chapter 7 petitions. It is nationally representative, with petitions from each of the 90 bankruptcy districts; and it is current, with petitions filed through December 1997.

The results are statistically reliable and can be used with confidence as representative of chapter 7 bankruptcy petitions nationwide. As shown in the chart, we have analyzed H.R. 833 with this database and we have found that 81 percent of chapter 7 filers in 1997 had gross incomes below the national median income, adjusted for family size. H.R. 833 would bar creditors from making motions against those debtors with below-median income.

Another 9 percent of chapter 7 filers had income above median income, but they would not meet H.R. 833's repayment presumption of the ability to repay at least $5,000 or 25 percent of their unsecured nonpriority debts after paying for living expenses and making secured debt payments.

Thus, 90 percent of chapter 7 filers in 1997 would not have been affected by H.R. 833's needs-based provision. Ninety percent would not be impacted by the needs-based provision. Only 10 percent, which would be roughly 100,000 chapter 7 filers at current levels, would have been required to file a repayment plan.

It is important to note that the percent of filers impacted is lower than the 15 percent that I talked about a year ago because we were analyzing H.R. 3150. Today we are analyzing H.R. 833. It has a higher income threshold than the initial H.R. 3150 that we analyzed a year ago, and it has a different repayment presumption.

Page 605 PREV PAGE TOP OF DOC

The proposal would impact principally higher income filers. The median gross income of the impacted filers in 1997 was $52,000. That is 46 percent higher than the 1996 U.S. national median income of only $35,500.

The approximately 100,000 impacted filers could potentially repay as much as $3 billion of their unsecured nonpriority debt under a 5-year repayment plan based on their current income. That is, after paying all secured debts such as a mortgage and auto loans, after paying priority debts such as alimony, child support and back taxes, and after a living expense allowance currently used by the Federal Government, impacted filers, 10 percent, could repay an average of 53 percent of their unsecured nonpriority debts.

Interestingly, we found that 4 percent, 4 percent of chapter 7 filers could repay 100 percent of their debts.

The median amount of unsecured nonpriority debt that impacted filers could repay over 5 years is about $21,000 or $360 per month, which represents about 8 percent of their gross monthly income. The potential amount of debt repayments clearly would depend on the filers' circumstances during the 5 years of bankruptcy.

You are in a position of looking at bankruptcy reform legislation whereas in all policy decisions one has to make the best possible simulations, using the best available information. Using debtors' income at the time of bankruptcy filing provides policymakers with what I think is a reasonable estimate, and clearly sensitivity analysis of those results could be done to refine that.

Page 606 PREV PAGE TOP OF DOC

In 19 years of doing policy analysis, including 10 years at the Treasury Department, I found it is helpful to have these types of estimates. This new national study of H.R. 833 provides a sound basis for action on bankruptcy reform. I think our study is the most comprehensive, and is the closest to looking at the actual legislative language in H.R. 3150 and H.R. 833. I would be happy to answer any questions about the Ernst & Young bankruptcy study.

[The prepared statement of Mr. Neubig follows:]

PREPARED STATEMENT OF THOMAS S. NEUBIG, ERNST & YOUNG LLP, WASHINGTON, DC

Mr. Chairman and Members of the Subcommittee:

I am the National Director of Ernst & Young LLP's Policy Economics and Quantitative Analysis group. I was previously the Director of the Treasury Department's Office of Tax Analysis.

I appreciate the opportunity to present the findings of the new Ernst & Young LLP study on Chapter 7 filers' ability to repay. The findings are based on a nationally representative study of 1997 bankruptcy petitions. I have included the report as an attachment to my statement.

The personal bankruptcy reform legislation you are considering is similar to prior reforms of the tax law, which often are influenced by personal anecdotes, but where detailed distributional data and simulation analysis is critical for making sound policy.

Page 607 PREV PAGE TOP OF DOC

The lack of a nationally representative study has been characterized as a limitation of other policy analyses of personal bankruptcy. That limitation does not apply to our study. Thus, we are able to evaluate what effect the needs-based provision of H.R. 833 would likely have had on Chapter 7 filers in 1997. We did not quantify the effects of other provisions of H.R. 833 which are also designed to reduce bankruptcy losses.

Nationally Representative Study

The data base upon which this study is based is the only statistically reliable national bankruptcy database ever created.

This database:

Is extensive. It includes over 2,100 Chapter 7 petitions.

Is broad. It includes petitions from each of the 90 bankruptcy district in the nation.

Is current. It includes petitions from each calendar month in 1997.

The results are statistically reliable and can be used with confidence.

I will highlight the study's findings.

Percentage of Chapter 7 Filers Likely Impacted

Page 608 PREV PAGE TOP OF DOC

As shown on the chart, we found that *81 percent* of Chapter 7 filers had gross income below the national median income (adjusted for family size). Creditors would be barred from making motions against these debtors.

Another *9 percent* of Chapter 7 filers had income above the median income but did not have the ability to repay $5,000 or 25% of their unsecured non-priority debts (after paying for living expenses and making secured debt payments).

Thus, *90 percent* of Chapter 7 filers would likely not be effected at all by H.R. 833's needs-based provision as they would not be subject to creditor motions or they have relatively low repayment ability.

Based on the nationally representative study, we can confidently predict that if the needs based provision had been in effect in 1997, *10 percent* of Chapter 7 filers, or about 100,000 filers, would likely have been required to file a Chapter 13 repayment plan.

Potential Recoveries and Repayment Ability

These approximately 100,000 filers with enough income and ability to repay could potentially repay $3 billion of their unsecured non-priority debt under a five-year repayment plan based on their current income. Actual repayments would depend on their circumstances during the next five years.

Based on their current income, these filers likely to be impacted could repay an average 53 percent of their unsecured non-priority debts. This is after paying all secured debt payments (such as a mortgage and auto loans), after paying priority debts (such as alimony, child support, and back taxes), and after a living expense allowance currently used by the Federal government.

Page 609 PREV PAGE TOP OF DOC

The median amount of unsecured non-priority debt that these impacted filers could repay over five years would be as much as $21,400, or $360 per month, which on average is about 8 percent of their current gross monthly income.

Effect on Different Income Groups

H.R. 833's needs-based provision would impact principally higher income filers. The median gross income of likely impacted filers was $52,000. This is 46 percent higher than the 1996 US national median income for all households of $35,500.

Expense Composition

In calculating debtor repayment ability, H.R. 833 requires using IRS standards for certain expenses (e.g., apparel, food) and actual debtor expenses for other expenses (e.g., health care, education, secured debts).

The majority of total expenses for likely impacted debtors are the debtors' actual expenses. Accordingly, the needs-based provision of H.R. 833 primarily reflects life style decisions *which the debtor has made.*

This national study finds similar results to an earlier Ernst & Young study of repayment ability of Chapter 7 filers in four cities during 1992 and 1993, and also the Georgetown Credit Research Center's study of filers in 13 cities during 1996.

Page 610 PREV PAGE TOP OF DOC

The potential amount of debt repayments would depend on the filers' financial circumstances during the five years after bankruptcy. Making assumptions in policy simulations is unavoidable and must be based on available information. Using debtors' current income provides policymakers with an estimate of potential debt repayments of $3 billion annually, which can then be subject to sensitivity analysis.

In 19 years of doing policy analysis, including 10 years at the Treasury, I've found that it is more helpful to have estimates based on how the proposed law would have applied in the past or estimates of the future based on reasonable assumptions, rather than waiting to validate every assumption or shy away from making projections that are common in most policy decisions. This new national study provides a sound basis for action on bankruptcy reform.

That concludes my testimony. I would be happy to answer any questions about the Ernst & Young bankruptcy repayment study.

63593ad.eps

CHAPTER 7 BANKRUPTCY PETITIONERS' REPAYMENT ABILITY UNDER H.R. 833: THE NATIONAL PERSPECTIVE(see footnote 161)

TOM NEUBIG, GAUTAM JAGGI AND ROBIN LEE(see footnote 162), Ernst & Young LLP

Executive Summary

Page 611 PREV PAGE TOP OF DOC

This study analyzes the effects of the needs-based bankruptcy provision of the "Bankruptcy Reform Act of 1999" (H.R. 833) on Chapter 7 filers. The study, and an earlier study by Ernst & Young LLP (Ernst & Young 1998b), are the only studies to date that evaluate repayment capacity on a *national basis*.

The analysis is based on a stratified random sample that is nationally representative for calendar year 1997. This sample is comprised of over 2,100 Chapter 7 bankruptcy petitions, which were selected from each of the 90 bankruptcy districts in the nation.

Key study findings are:

10 percent (approximately 100,000) of 1997 Chapter 7 filers are likely to have been impacted by the needs-based provision of H.R. 833 and required to file Chapter 13.(see footnote 163) (See Chart 1).

— These filers would have had the ability to repay 53 percent, or almost $3 billion, of their unsecured non-priority debts over five years. These filers could have repaid $7 billion of total Chapter 7 debt, including secured, unsecured and priority debt. This assumes that their income remains unchanged relative to expenses and liabilities during the 60 month repayment period.

The filers likely impacted by H.R. 833 are higher income filers:

— The median gross income of likely impacted filers is more than twice that of Chapter 7 filers not impacted ($51,974 vs. $21,204), and is 46 percent higher than the 1996 US national median income for all households ($35,492).

Page 612 PREV PAGE TOP OF DOC

The needs-based bankruptcy provision in H.R. 833 is likely to impact higher income petitioners with demonstrated ability to repay their debts. For purposes of this analysis, the filers likely to be impacted and required to enter a Chapter 13 repayment plan are those who are subject to creditor motions and who meet the repayment ability presumption criteria.

Median Income Test

Debtors with incomes below the national median (adjusted for family size) would not be subject to creditor motions and therefore would likely not be impacted. Conversely, creditors may bring motions against petitioners with incomes in excess of the family median.(see footnote 164)

Repayment Ability Presumption

H.R. 833 assumes that "abuse exists" for Chapter 7 debtors with the ability to repay at least 25 percent or $5,000 of their unsecured non-priority debts within five years, after paying for secured and priority debt payments and living expenses. These filings must be either dismissed or converted to Chapter 13 unless a debtor can demonstrate extraordinary circumstances that require an adjustment of income or expenses that causes the debtor's repayment capacity to fall below the lesser of 25% or $5,000.

Thus, likely impacted filers are those making above the national median and who are presumed to be abusive.

Page 613 PREV PAGE TOP OF DOC

It is important to emphasize that this analysis only measures the needs-based provision of H.R. 833. This pending House legislation contains numerous other provisions (e.g. financial counseling, random audits, verification of income, etc.) which would reduce bankruptcy losses. Quantifying the impact of these other provisions is beyond the scope of this study.

63593ae.eps

1. Introduction

In 1998, personal bankruptcy filings reached an all-time high of almost 1.4 million.(see footnote 165) The record levels of filings in recent years contrast sharply with the state of the overall economy, which has grown steadily and experienced low levels of unemployment and high consumer confidence. The dichotomy between the healthy economy and the number of filings has focused attention on current bankruptcy laws. Reform proposals are being considered by Congress, and their impact on the number of bankruptcy filers and debt repayment in the bankruptcy system are important factors to consider in the public policy debate.(see footnote 166)

While several previous research studies have investigated petitioner repayment capacity, this study and Ernst &

Young's March 1998 study (Ernst & Young, 1998b) are the only studies that evaluate repayment capacity comprehensively on a *national basis*. The national database of 1997 bankruptcy petitions, herein referred to as the "1997 Visa national bankruptcy database," includes more than 2,100 Chapter 7 bankruptcy filings. A detailed description of this database and the sampling procedures used, can be found in Ernst & Young (1998b). This study calculates the effects of the needs-based bankruptcy provision of H.R. 833, the "Bankruptcy Reform Act of 1999."

Page 614 PREV PAGE TOP OF DOC

The needs-based provision of H.R. 833 would likely impact Chapter 7 petitioners and require them to file under Chapter 13 if they have incomes above the national median adjusted for family size(see footnote 167) and the ability to repay either $5,000 or 25 percent of their unsecured non-priority debts within 5 years, after making secured and priority debt payments and paying for living expenses. If the law had been in effect in 1997, 10 percent of Chapter 7 filers would likely have been impacted by the needs-based provision and required to file Chapter 13.

This study is divided into five sections, beginning with this introduction (Section 1). Section 2 gives a general description of the 1997 Visa national bankruptcy database. Section 3 presents key findings about the impact of the needs-based provision. Calculation details on repayment ability under the needs-based provision of H.R. 833 are presented in Section 4, followed by concluding comments in Section 5.

2. Description of the 1997 Visa National Bankruptcy Database

Since 1995, as a service to its member financial institutions, Visa has maintained a national bankruptcy notification service (BNS) which records virtually all non-business bankruptcy filings. This study began by taking a sample from the 1997 BNS, which included all 11 federal court circuits and 90 districts. The sample was drawn in two stages: the first stage sample was extracted into a computer file by Visa, based on Ernst & Young's specifications; the second stage sample was randomly selected from this file by Ernst & Young statisticians.(see footnote 168)

Page 615 PREV PAGE TOP OF DOC

The first stage sample was designed to have sample sizes of approximately 500 Chapter 7 petitioners for each of the 90 districts in the United States.(see footnote 169) This sample of 43,730 cases was drawn randomly in each district to ensure that the monthly sample was proportionate to the actual monthly volume in that district. The second stage sample consisted of about 2,200 petitions, 200 of which were Chapter 7 asset cases.(see footnote 170)

In the second stage sample, the district sample sizes were determined by allocating the total sample in proportion to each district's volume within each month of filing. This was supplemented by sampling additional observations from the smallest districts, so that each had a minimum of about a dozen cases.(see footnote 171) Table 1 shows the distribution of petitions by chapter that were finally selected in the first and second stages of sampling.

Table 16

The U.S. bankruptcy courts were the source for all of the petitions obtained for the 1997 sample database. A listing of the cases to be included in the final sample was sent to an outside vendor who obtained the designated petitions from the applicable court. The petitions obtained were then copied and transmitted for data entry at Visa, where virtually all of the information on the petitions was captured. During the data gathering process, Ernst & Young monitored all steps—including selecting a subsample of cases for independent reprocessing.

The sampling was highly successful. One indication of this is shown in Table 2, which connects the sample to the population about which inferences are to be made. Columns 1 and 2 show the total number of 1997 Chapter 7 petitions by circuit, first as obtained from BNS (Column 1), and then as obtained from official sources (Column 2).(see footnote 172) Column 3 shows the universe of 1997 petition filings after eliminating cases estimated to be dismissed. Column 4, designated "Final Selected Sample," corresponds to the "second stage sample" discussed earlier and summarized in

Table 1. The last column of the table, Column 5, consists of the sample determined usable.(see footnote 173) The differences between Column 4 and 5 are quite small; on an overall basis, the usable sample was about 97 percent of the size of that selected.

Page 616 PREV PAGE TOP OF DOC

Table 17

3. Key Findings

The analysis in this section focuses only on the needs-based provision of H.R. 833, which likely impacts petitioners with monthly income above the national median for families of comparable size and the ability to repay either $5,000 or 25 percent of their unsecured non-priority debts within 5 years, after making secured and priority debt payments and paying for living expenses.(see footnote 174)

Share of Filers Likely Impacted

The share of 1997 Chapter 7 filers likely to be impacted by the needs-based provision of H.R. 833 is shown in Table 3. As shown, 10 percent of 1997 Chapter 7 filers would have probably been required to file under Chapter 13, if H.R 833's needs-based bankruptcy provision had been in effect in 1997.

For purposes of this analysis, Chapter 7 filers are considered to be likely impacted by H.R. 833 if they are eligible for creditor motions (that is, they have income above the national median) and they meet the abuse presumption. Chart 2 shows the cumulative percentage of filers likely impacted by each of the criteria used to determine a petitioner's need for relief under the proposed legislation. As shown:

19 percent of 1997 Chapter 7 filers had income above the national median, adjusted for family size;

Page 617 PREV PAGE TOP OF DOC

10 percent of filers had income above the national median and the ability to repay either $5,000 or 25 percent of their unsecured non-priority debts within 5 years after making secured and priority debt payments and paying for living expenses.

The estimate that 10 percent of filers are likely to be impacted under the needs based provision is based on petitioners' reported 1997 income at the time of filing. If reported 1996 income were used instead, the share of likely impacted filers would rise to 14 percent. Accordingly, the likely impacted estimate of 10 percent is conservative. More details are provided in Section 4.

Table 18

63593af.eps

Debt Repayment Capacity

The 1997 Chapter 7 filers likely impacted by H.R. 833 would have had the ability to repay 55 percent of their total debts, if income remained unchanged relative to expenses and liabilities during the 60 month repayment period.(see footnote 175) When broken down by type, the corresponding repayment figures are 56 percent for secured and priority debt owed and 53 percent for unsecured non-priority debt owed. These figures are shown in Table 3.

In dollar terms, the estimated amounts of debt repayable by filers likely impacted by the needs-based provision in 1997 are $4 billion in secured and priority debt, and $3 billion in unsecured non-priority debt, over the five year repayment period.

Page 618 PREV PAGE TOP OF DOC

In other words, the 10 percent of Chapter 7 filers likely to be impacted could repay about $7 billion of the $75 billion (or 9 percent) of total Chapter 7 debt at risk within 5 years. Of the $7 billion repayment, trustees would receive between $93 and $249 million, with the remaining funds to be received by creditors.(see footnote 176)

More details on the distribution of repayment ability across debtors are provided in Table 4. As shown, about 5 percent of Chapter 7 filers could repay all their unsecured non-priority debts, even after allowing for secured and priority debt repayments and living expenses. About 4 percent had the ability to repay all their debts, and also had incomes above the national median adjusted for family size.

Table 19

Debt and Income Profiles of Filers Likely Impacted and Not Impacted Under H.R. 833

Filers likely impacted in 1997 under H.R. 833 had median incomes ($51,974) considerably above the 1996 national median income ($35,492) for all households(see footnote 177) (US Bureau of the Census, 1997b). Filers not impacted by the provision earned less than half at the median ($21,204) of that earned by filers likely to be impacted. In addition, filers impacted had more unsecured non-priority debt ($39,085 at the median) than filers not impacted ($23,472 at the median). Chart 3 displays these results. Not surprisingly, likely impacted filers also had higher repayment capacity than the typical Chapter 7 filer: the median amount of unsecured non-priority debt that impacted filers could repay over five years was $21,372; the comparable figure for all Chapter 7 filers was zero.

Page 619 PREV PAGE TOP OF DOC

Expenses of Filers Likely Impacted Under H.R. 833

The ability of filers to repay unsecured non-priority debt under the needs-based test was assessed on the basis of their incomes and expenses. The expenses of filers can be broadly classified into two categories: (1) "actual expenses," which include expenses that were taken from Schedule J on the bankruptcy petitions and secured and priority debt repayment expenses based on the actual debt of debtors; and (2) "IRS standards," which include expenses used in the needs-based calculation that were taken from the IRS expense allowances. For likely impacted filers, the majority of expenses used in the needs-based calculation were obtained from the actual expenses of individual debtors, rather than from the IRS standards.(see footnote 178) Thus, the needs-based provision of H.R. 833 primarily reflects life style decisions which the debtors have made.

63593ag.eps

Comparison with Other Studies

The results of this study are consistent with several recently released studies. For example, earlier Ernst & Young analyses found that 12 percent of 1992/93 Chapter 7 filers in four court districts and 15 percent of Chapter 7 filers across the US would have been impacted by the needs-based provision of H.R. 3150 had it been in effect at the time.(see footnote 179) All of these studies corroborate the 1997 Georgetown study's conclusion that "a sizable minority of Chapter 7 debtors could make a significant contribution toward repayment of their non-housing debt over a five year period."(see footnote 180) The cumulative weight of all four studies supports a consistent finding: that large numbers of Chapter 7 filers have the ability to repay a substantial portion of their debts.

Page 620 PREV PAGE TOP OF DOC

The American Bankruptcy Institute study,(see footnote 181) by Marianne Culhane and Michaela White, reported somewhat less repayment capacity—the authors report that 3 percent of filers in their 1995 sample from seven districts would have been impacted. This study and the ABI study estimate the impact of different needs-based provisions. In addition, they differ on a critical interpretation of the legislative proposal with respect to the treatment of automobile debt. The ABI study assigned debtors with cars the greater of the IRS automobile ownership allowance or their monthly automobile debt payments. In fact, the debtors in the ABI study were provided the IRS ownership allowance even if they had no car loan. This approach is consistent with neither the needs-based test in H.R. 833 nor the needs-based test that they evaluated, both of which specifically allow only the debtor's actual secured debt payments and exclude IRS standards that are "payments for debts." Instead, the needs-based provisions require that debtors be allowed to deduct the average monthly payments on account of secured debts over the 60 month repayment period. In keeping with this, this study amortized automobile debt over 60 months. This approach more accurately reflects the legislative language in H.R. 833.

The different approaches of the two studies towards trustee fees is discussed in the "Issues of Interpretation" section below. As explained, changing this assumption has virtually no impact on the findings.

Issues of Interpretation

The following points about the analysis of the impact of the needs-based provision contained in H.R. 833 should be noted:(see footnote 182)

Page 621 PREV PAGE TOP OF DOC

(1) As defined by H.R. 833, the repayment calculations assume all secured and priority debt(see footnote 183) is paid first, whether reaffirmed or not. The remaining repayment ability of the debtor is stated as a share of total unsecured non-priority debt.

(2) The calculations use petition data submitted by petitioners—that is, all data were taken from the actual petitions, as filed by debtors. While submitted under oath, these data are unaudited, unless the petition is challenged by a creditor or trustee. Some have suggested that Chapter 7 filers may have an incentive to exaggerate their financial distress by overstating expenses and understating income.

(3) H.R. 833 provides that Chapter 13 plans can be adjusted over the repayment period to reflect changes in circumstances. However, to "score" the proposed legislation, the repayment calculations assume that the petitioners' future income relative to expenses and liabilities during the five year period is the same as their current income relative to expenses and liabilities as reported on the bankruptcy petition. For petitioners whose income relative to expenses and liabilities increases over the five year period, this assumption would underestimate repayment ability. Conversely, the assumption would overestimate the repayment ability of petitioners whose income relative to expenses and liabilities declines during the five year period.(see footnote 184)

(4) The needs-based test does not incorporate trustee fees incurred in Chapter 13 filings. In practice, trustee fees would be borne after the administration of the needs-based test. Hence, these fees would not be included as priority debt payments when the needs-based test is administered. While trustee fees would not be included when administering the needs-based test, their subsequent imposition would lower debt repayment by debtors. Consequently, the estimated amount of debt repayable includes estimates for these expenses. While this approach accurately reflects the needs-based test in H.R. 833, including trustee fees would not have any significant impact on the share of filers likely impacted. Testing the sensitivity of the results to the inclusion of trustee fees as part of the needs-based test revealed that the share of likely impacted filers is 10 percent, whether or not trustee fees are included.(see footnote 185)

Page 622 PREV PAGE TOP OF DOC

4. Methodology for Calculation of Repayment Ability

This section describes the methodology used to calculate repayment ability under the needs-based provision of H.R. 833, as implemented given the data available.

Basic Calculation

The needs-based repayment measure is based on the following formulas:

1. Repayable Amount

Projected Monthly Net Income *60

2. Projected Monthly Net Income

Current Monthly Total Income—Monthly Expenses

3. Current Monthly Total Income

Current monthly income on Schedule I. For joint filers, income and deductions included spousal income and deductions.

Page 623 PREV PAGE TOP OF DOC

4. Monthly Expenses

Transportation Expenses + Housing and Utility Expenses (for non-homeowners) + Mortgage Debt Service, Utility and Home Maintenance Payments (for homeowners) + Other Living Expenses + Other Necessary Expenses + Secured Non-mortgage Debt Service Payments + Priority Debt Payments + Business Expenses

"Current monthly total income" is defined by H.R. 833 as "the average monthly income from all sources derived which the debtor, or in a joint case, the debtor and the debtor's spouse, receive without regard to whether it is taxable income, in the 180 days preceding the date of determination . . ." The current petition schedules do not capture average income over the 180 days prior to filing. Analysis of the data revealed that, on average, current monthly income on Schedule I was lower than the prior year's (1996) income from employment, business and other sources from Form 7 divided by 12. Current monthly income from Schedule I was therefore used as a conservative approach which underestimates the amount of repayment ability under H.R. 833. Repayment calculations were also done using prior year's income. Using 1996 income, the fraction of Chapter 7 filers likely impacted by the needs-based provision would have risen to over 14 percent. It is reasonable to expect that the average income over the six months prior to filing would lie within the range represented by current monthly income and prior year's income.

The repayable amount as described above was calculated for households meeting the minimum income requirements specified by H.R. 833, i.e., only households whose income exceeded 1996 median national income for families of comparable size as reported by the Census Bureau. While family size data is not currently required on bankruptcy petitions, family size was estimated and included in the database. For individual petitions, family size was determined by adding one to the number of dependents listed on Schedule I. For joint petitions, two was added to the number of dependents listed.

Page 624 PREV PAGE TOP OF DOC

Filers were considered likely to be impacted under the plan if their repayable amount exceeded either $5,000 or 25 percent of their unsecured non-priority debt and if their income exceeded the national median adjusted for family size.

Unsecured non-priority debt includes finance company and personal loans, credit card loans, student loans, and other miscellaneous debts.

Expense Items

The monthly expense items are described in detail below. The 1997 IRS National Collection Standards were used for food, housekeeping supplies, apparel & services, personal care products and services and miscellaneous expenses. Local IRS standards were used for housing, utilities and transportation expenses.(see footnote 186)

(1) Housing and utility expenses. IRS standard expenses for housing and utilities are determined according to the county and family size. Since H.R. 833's needs-based bankruptcy provision would allow the IRS standard expense in the absence of mortgage payments, non-homeowners(see footnote 187) were allowed the IRS standard housing and utility expense for the relevant county and estimated family size. Conversely, homeowners were allowed to deduct their mortgage payments (discussed below), home maintenance expenses, and utility expenses for electricity and heating, water, sewer and telephone, as reported on Schedule J.

Page 625 PREV PAGE TOP OF DOC

(2) Transportation expenses. IRS standards for automobile operating costs and public transportation are determined by census region; there are also IRS standards for a number of large US cities. The reported county was used to assign petitioners' transportation expenses. If the county was in a metropolitan statistical area that contained one of the cities with separate IRS transportation expense, then the transportation expense for that city was used. Otherwise, the petitioner was assigned the transportation expense for the appropriate region. IRS transportation expenses also depend on the number of vehicles.(see footnote 188) IRS standards generally make allowance for necessary or income producing expenses. There is no information on the bankruptcy petitions indicating whether a petitioner's vehicle meets this test. Therefore, transportation expenses were assigned to petitioners based on the number of vehicles reported on the petition, regardless of whether or not all of the vehicles were necessary. The only exception made was for debtors with a family size of one who had more than one vehicle. In this case, it seems reasonable to allow transportation expenses based on one vehicle.

The IRS standards also include allowances for automobile ownership costs. These allowances are intended to cover automobile debt payments. However, H.R. 833 specifically excludes IRS standards that are "payments for debts," and instead requires that debtors be allowed to deduct the average monthly payments on account of secured debts over the 60 month repayment period. Therefore, automobile debt was amortized over 60 months along with secured non-mortgage debt, as described below.

(3) Other living expenses. The IRS national standards for living expenses include allowances for housekeeping supplies, apparel and services, personal care products and services, food, and miscellaneous items. These expenses are determined according to household gross monthly income and the number of individuals in the household. Accordingly, all petitioners were assigned these expenses based on their gross income and estimated family size.

Page 626 PREV PAGE TOP OF DOC

(4) Other necessary expenses. The H.R. 833 provision also allows filers to claim "other necessary expenses" based on IRS guidelines. Consistent with the needs-based bankruptcy provision, the following reported monthly expenses were deducted from monthly income: alimony, charity, child care, health insurance, medical expenses, taxes and payroll deductions (payroll taxes, social security, insurance, union dues, and other taxes not deducted from wages or included in home mortgage payments). All of these items were taken as reported by the petitioner on Schedules I and J. As a conservative approach, all charitable expenses were used, even though the IRS limits the type of charitable contributions which are allowed. Similarly, all taxes were used as listed on Schedule J. It is likely that some petitioners listed their monthly payments for back taxes on Schedule J. For such filers, the calculation would double count

monthly back tax payments twice: once as shown on Schedule J, and once on the basis of calculated monthly back tax payments based on amortization of priority debt (see section on "Priority and Secured Non-Mortgage Debt Payments" below). All of these conservative approaches tend to underestimate the share of debtors impacted and the amount of debt repayable under the needs-based provision.

(5) Mortgage Debt Service, Utility and Home Maintenance Payments. As discussed in the section on housing and utility expenses above, mortgage debt payments were only allowed for homeowners. Two adjustments were made to the reported mortgage debt payment amount: (a) if income after non-debt-payment expenses was insufficient to make the entire mortgage payment reported, then the available income was used instead, and (b) if 85 percent of reported current monthly mortgage payments multiplied by 60 was greater than 110 percent of the outstanding mortgage debt, then the outstanding mortgage debt was repayable in less than 60 months, and the average monthly mortgage payment was calculated by dividing 110 percent of the outstanding balance by 60.(see footnote 189) In addition, homeowners were allowed utility expenses for electricity and heating, water, sewer and telephone, and home maintenance expenses for repairs and upkeep, as reported on Schedule J.

Page 627 PREV PAGE TOP OF DOC

(6) Priority and Secured Non-Mortgage Debt Service Payments. Secured and priority debt was amortized over 60 months by dividing the total secured and priority debt by 60 (ten percent was added to outstanding amounts of secured non-mortgage debt and back taxes to allow for interest).(see footnote 190) H.R. 833 allows for amortization of priority debt by dividing the outstanding priority debt by 60. Allowing for interest on back taxes is a conservative approach which underestimates the ability to repay debt under H.R. 833. Estimated attorney fees payments were included as priority debt payments. Attorney fees were calculated for each individual debtor as the difference between the $1,281 average total attorney fees for Chapter 13 plans(see footnote 191) and the amount paid up front by individual debtors, as reported on their petitions.

(7) Business Expenses. Debtors were also allowed business expenses as reported on Schedule J. However, these expenses were only allowed for petitioners that reported business income on Schedule I.

5. Conclusions

The results presented in this report indicate that large numbers of 1997 U.S. Chapter 7 filers had the ability to repay large portions of their debts. In particular, this study shows that:

10 percent of 1997 Chapter 7 filers would likely have been likely impacted by the needs-based provision of H.R. 833, had it been in effect in 1997.

Page 628 PREV PAGE TOP OF DOC

These filers could have repaid 55 percent of their total debts over five years. When broken down by type of debt for filers likely impacted, the corresponding repayment figures are 56 percent for secured and priority debt owed, and 53 percent for unsecured non-priority debt.

An estimated $7 billion of Chapter 7 debt could have been repaid within five years by the filers likely impacted.

Filers who likely would have been impacted by H.R. 833's needs-based provision had relatively higher incomes:

Impacted filers had median gross annual income of $51,974, compared to $21,204 for those unaffected.

Impacted filers also had more unsecured non-priority debt ($39,085 at the median) than those not impacted ($23,472 at the median).

The 1997 findings corroborate several earlier studies using different databases and different methodologies. Taken together with this earlier work, the 1997 Visa national bankruptcy database continues to be a sound basis for action on bankruptcy reform.

References

Administrative Office of the U.S. Courts. (1998) "Increase in Bankruptcy Filings Slows in Fiscal Year 1998".

Page 629 PREV PAGE TOP OF DOC

American Bankruptcy Institute. (1998) "Means-Testing For Chapter 7 Debtors: Repayment Capacity Untapped?" M. Culhane and M. White, mimeo.

Barron, J. and M. Staten. (1997) "Personal Bankruptcy: A Report on Petitioners' Ability-to-Pay," mimeo. Credit Research Center, Georgetown University.

Chapman, D. (1983) "The Impact of Substitution on Survey Response" in *Incomplete Data in Sample Surveys*, Volume 2.

Ernst & Young. (1998a) "Chapter 7 Bankruptcy Petitioners' Ability to Repay: Additional Evidence from Bankruptcy Petition Files." T. Neubig, F. Scheuren, G. Jaggi, and R. Lee, mimeo.

Ernst & Young. (1998b) "Chapter 7 Bankruptcy Petitioners' Ability to Repay: The National Perspective, 1997." T. Neubig, F. Scheuren, G. Jaggi, and R. Lee, mimeo.

Federal Reserve Board. (1997) *Federal Reserve Bulletin.*

Hansen, M., W. Hurwitz, W, and W. Madow. (1953) *Sample Survey Methods and Theory* (Vol. 1).

U.S. Internal Revenue Service. (1997) "Collection Financial Standards". *http://www.irs.ustreas.gov/prod/ind—info/coll—stds/*

U.S. Bureau of the Census. (1997a). "Table F–8. Size of Family—Families by Median and Mean Income: 1947 to 1996". *http://www.census.gov/hhes/income/histinc/f08.html*

Page 630 PREV PAGE TOP OF DOC

U.S. Bureau of the Census. (1997b). "Table H–12. Earners—Households (All Races) by Median and Mean Income: 1980 to 1997." *http://www.census.gov/hhes/income/histinc/h12.html*

U.S. Government Accounting Office (1998), "Personal Bankruptcy: The Credit Research Center Report on Debtors' Ability to Pay."

U.S. Government Accounting Office, (1994) "Bankruptcy Administration: Case Receipts Paid to Creditors and Professionals". GAO/GGD–94–173.

Visa (1997). "Bankruptcy Petition Study," Visa Consumer Bankruptcy Reports.

Mr. **GEKAS.** We thank the gentleman, and we turn to our final witness.

STATEMENT OF RICHARD M. STANA, ASSOCIATE DIRECTOR, ADMINISTRATION OF JUSTICE ISSUES, GENERAL GOVERNMENT DIVISION, GENERAL ACCOUNTING OFFICE, WASHINGTON, DC

Mr. **STANA.** Mr. Chairman and members of the subcommittee, I am pleased to be here today to share our observations on the principal methodological similarities and differences of three reports on bankruptcy debtors' ability to pay their debts. These reports, done by the Credit Research Center in 1997, Ernst & Young—and we analyzed last year's study, I just received this year's study this morning—and Creighton University/ABI, endeavor to address an important public policy issue, and that is whether some proportion of debtors who file for personal bankruptcy have sufficient income after expenses to pay a substantial portion of their debts.

Page 631 PREV PAGE TOP OF DOC

The Credit Center report estimated that 30 percent of the chapter 7 debtors in its sample could pay at least 21 percent of their nonhousing, nonpriority debt, after deducting their mortgage debt payments and living expenses, exclusive of debt payments. The 1998 Ernst & Young and the latest ABI study estimated that 15 percent and 3.6 percent, respectively, of the debtors in their individual samples had sufficient income after deducting allowable living expenses to pay all of their nonhousing secured debts, all of their unsecured priority debts, and at least 20 percent of their unsecured priority debts.

These reports have some characteristics in common. For example, they all use to some degree debtor-prepared income, expense and debt schedules, which are the only source of the detailed data needed for an analysis of repayment capacity, but nevertheless are of unknown accuracy and reliability. And they share the assumption that the debtors' income would remain stable relative to debts over a 5-year repayment period and that all debtors who entered a 5-year repayment plan would successfully complete the plans. Historically, only about a third of chapter 13 debtors, and these were debtors who volunteered to go into chapter 13, have successfully completed their repayment plan, suggesting that for two-thirds of debtors something changed between the time the plans were confirmed by the bankruptcy court and the time the actual repayment plan was to be successfully completed.

None of the reports estimated the additional costs that would be borne by the government, which CBO estimates would be about a quarter of a billion dollars over 5 years for the additional bankruptcy judges and administrative support that would be needed if more debtors were required to file under chapter 13.

Page 632 PREV PAGE TOP OF DOC

Now the three reports also had several key methodolical differences that contributed to the different estimates of debtors' repayment capacity. First, the Credit Center report grouped the types of debts that could be repaid differently. It estimated the percentage of chapter 7 debtors who could repay a percentage of their nonhousing, nonpriority debt after deducting from gross income monthly mortgage payments and monthly living expenses. The other two reports estimated the proportion of chapter 7 debtors who had sufficient income after living expenses to repay all of their nonhousing secured debt such as automobile loans, all of their unsecured priority debt such as taxes and child support, and at least 20 percent of unsecured nonpriority debt such as credit card debt. Second, different sampling techniques were used, and I think we have heard those described earlier so I won't go into that.

Third, the reports differed with respect to repayment capacity assumptions. The Credit Center report was completed before H.R. 3150 was introduced and its repayment capacity analysis was not based on any specific legislation. Rather, it analyzed repayment capacity regardless of the debtor's gross income. On the other hand, the Ernst & Young and the ABI report used the needs-based provision of different versions of H.R. 3150, with different gross annual income screens, as the basis for their analysis for debtor repayment capacity.

Fourth, the three reports used different estimates of debtors' allowable living expenses. The Credit Center's analysis used debtors' living expenses as reported on the debtors' schedule of monthly living expenses. The Ernst & Young and ABI reports used the IRS financial collection standards, although they interpreted them somewhat differently. The principal difference was for transportation expenses. Ernst & Young did not include an automobile ownership allowance for debtors who leased cars or for whose cars were debt-free. ABI did so. ABI estimated that this difference in transportation allowance accounted for a substantial portion of the difference between the results of the two reports.

Page 633 PREV PAGE TOP OF DOC

Fifth, ABI also deducted from debtors' total unsecured priority debt the value of any student loans and added the value of these loans to debtors' total unsecured priority debt. To the extent this was done, it had the effect of freeing debtor income to pay unsecured priority debt.

Finally, the ABI report assumed that administrative expenses such as the trustee fee would consume about 5.6 percent of debtors' nonmortgage payments to creditors under a 5-year repayment plan. The Credit Center and Ernst & Young reports assumed that none of the debtors' payments would be used for administrative expenses but that 100 percent of debtors' payments would be used to pay creditors.

In summary, each of the three reports provides a different perspective on bankruptcy debtors' ability to pay their debts. Each has added to our knowledge and understanding of the potential impact of means testing on the number of debtors who would be required to file under chapter 13 and the amount of debt that such debtors could potentially repay.

However, the assumptions and data used in these reports lead to different estimates of debtors' repayment capacity, and require the reader to use caution in interpreting and using the results of each report. The actual number of chapter 7 debtors who could repay at least a portion of their nonhousing debt could be more or less than the estimates in these studies. Similarly, the amount of debt these debtors could potentially repay could also be more or less than the reports estimated.

We agree that there are likely some debtors who file for bankruptcy under chapter 7 who have the financial ability to repay at least a portion of their debt. And we agree that those who are able to do so should pay their debt. But we believe that more research is needed to verify and refine the estimates of debtors' repayment capacity, to better inform policymakers and set the screens at the appropriate level.

Page 634 PREV PAGE TOP OF DOC

Thank you, Mr. Chairman.

[The prepared statement of Mr. Stana may be found on the GAO website at http//www.gao.gov or it may be ordered (Report Number GAO/T–GGD–99–58.)]

Mr. **GEKAS.** We thank the witnesses.

Mr. **NADLER.** One quick question of Mr. Stana. Last year when Professor Staten was here—Dr. Neubig was here, too—we asked if we could see the background data for the two studies. With respect to all three studies, have you been able to see the background data for the three studies or for any of them?

Mr. **STANA.** We are doing some work for Senator Grassley on the ABI study, and Professor Culhane has provided us the background and the data set for us to do that analysis. We have not been given the data set for the other two studies.

Mr. **NADLER.** Thank you, sir.

Mr. **GEKAS.** One of the final statements by Mr. Stana, to the effect that these three studies have increased our understanding of the goals that we have set for ourselves in the reform effort—to make sure that those who can repay shall repay, and that those who require and need a fresh start will get that fresh start—all of them are implicit in the outcome of the studies and will be very helpful to us in the conclusions that we will draw. We thank the panel for——

Page 635 PREV PAGE TOP OF DOC

Mr. **WATT.** Mr. Chairman, I stepped out. Could I just ask two questions?

Mr. **GEKAS.** The gentleman is recognized.

Mr. **WATT.** Number one, did either study consider—there was some testimony on the last panel about people who met the means test who are now filing chapter 13 may be incentivized to go in the opposite direction. Do any of these studies take that into account or evaluate that?

Ms. **CULHANE.** We did not.

Mr. **STANA.** No. There is another issue related to that, and that is, historically about a third who originally filed voluntarily under chapter 13, and circumstances forced them to migrate back to chapter 7.

We believe that is an important factor that hasn't been analyzed in any of these studies. Also, it would suggest that less than 100 percent of these repayment plans that the studies assume will be completed, will actually be completed, and that a sensitivity analysis on this would be very helpful.

Mr. **WATT.** One other thing. Given the relatively small number that this is going to impact, do any of the studies evaluate the additional costs that get imposed on either the 90 percent or 96.4 percent, depending on which study you use, of adding all of this additional paperwork burden and complying with the new stuff that is required to make this determination?

Page 636 PREV PAGE TOP OF DOC

Mr. **STANA.** No, and I think that is an important point also, Mr. Watt. There is a considerable expense to the government and to the debtors who file under chapter 13, and unless we know how many of these chapter 13 cases under means testing are likely to be successfully completed, we won't know the cost benefit of going to the system as the screens are currently structured.

Mr. **WATT.** Thank you, Mr. Chairman.

Mr. **GEKAS.** The other side of that coin is, under our means-testing procedure with the median income as high as it was, the ones that failed and went back to chapter 7 from chapter 13 would never have gotten there in the first place because of the higher median threshold that we had established, in my judgment.

Mr. **NADLER.** Do we have any data to say that is true or not?

Mr. **STANA.** I don't know the composition of the current chapter 13s that have migrated back to chapter 7.

Mr. **NADLER.** Mr. Chairman, I ask unanimous consent that our members have 5 legislative days to submit additional questions.

Mr. **GEKAS.** Without objection.

Mr. **NADLER.** Thank you.

Page 637 PREV PAGE TOP OF DOC

Mr. **GEKAS.** We thank the panel. This hearing is adjourned.

[Whereupon, at 2:50 p.m., the subcommittee was adjourned.]

(Footnote 1 return)
If you can prove that it is a "hardship" for you to pay this amount, the court will grant you a discharge even if she does file.

(Footnote 2 return)
The following description of consumer bankruptcy law is found in Judge Eugene Wedoff's Statement to the Subcommittee on Commercial and Administrative Law, House Committee on the Judiciary, March 18, 1998. The full statement may be found at *http://www.abiworld.org/legis/testimony/98marwedoff.html*.

(Footnote 3 return)
Just two years ago, supporters of a bankruptcy overhaul said the hidden tax was $100 a year per American family. Last fall, the hidden tax was $400 a year. Now, the hidden tax apparently has increased to $550 a year. The data justifying these figures have not been made available.

(Footnote 4 return)
Under section 102 of this bill, courts are required to presume that a case is abusive at *any income level* if the debtor's income is sufficient to pay the lesser of 25% of debts or $5,000 over five years after applying the IRS expense allowances and the remainder of the formula. *See* section 102, proposed 11 U.S.C. §707(b)(2)(A)(i). Likewise, this bill requires that trustees review all individual chapter 7 cases for the debtor's ability to pay under the means test and submit a statement on their findings in each case to the court, regardless of the debtor's income level. *Id.* Proposed 11 U.S.C. §704(10).

(Footnote 5 return)
The Conference has some concerns, however, regarding the provisions in the Bankruptcy Reform Act of 1999, to which the co-sponsors refer as "bold new provisions for consumers," as they appear to require that bankruptcy petition preparers give legal or quasi legal advice in contravention of state bar ethical requirements.

(Footnote 6 return)
Policy questions aside, these guidelines are fraught with logistical difficulty. For example, the IRS's Other Necessary Expenses allowance, which purportedly covers a wide range of miscellaneous items, provides no guidance at all because it makes all expenses discretionary with the IRS. See IRS Manual at 5323.434 (rev. 1995) (stating that some expenses are usually considered to be necessary, some may be deemed necessary depending on individual circumstances, some will be gauged by dollar amount listed, others must be meet specific tests satisfactory to the IRS, and still others may be allowable but the IRS representative must document his reasons). It never has been clear how these could be applied without a court hearing to determine whether each expense is allowable.

(Footnote 7 return)
Debts to credit card companies already are nondischargeable if the creditor proves that the debtor incurred the charge with the intent not to repay it. *See* 11 U.S.C. §523(a)(A). Credit card companies also benefit from the current presumption of nondischargeability for cash advances and luxury good purchases that aggregate more than $1,075 to a

single creditor. *Id.* §523(a)(2)(C). In addition, section 707(b) has been used on many occasions to dismiss chapter 7 cases in which the debtor has incurred excessive credit card debts. *See, e.g., In re Laman*, 221 B.R. 379 (Bankr. N.D. Tex. 1998) (dismissing chapter 7 case in which debtor owed over $88,000 on 23 credit cards); *In re Uddin*, 196 B.R. 19 (Bankr. S.D.N.Y. 1996) (dismissing chapter 7 case in which debtor accumulated over $170,000 in credit card debt in under eight months).

(Footnote 8 return)
For example, section 126 of this bill denies the use of a state's exemption to a family of modest means if the family has not lived in the state for the past 730 days. We all know families who have moved several times, perhaps due to a job being transferred or laid off or to join the household of other relatives. Although the intent of this amendment is ambiguous, some consumer bankruptcy experts believe that this amendment will strip some financially struggling families in bankruptcy of all property exemptions. This means that the trustee could take and sell all of the bankrupt family's possessions, including a modest home, an old automobile, clothes, inexpensive children's toys, books, pots and pans, and family pictures.

(Footnote 9 return)
Indeed, whether or not current bankruptcy law could be improved to expedite business bankruptcy cases, the parade of horribles is *less* likely to occur in a business that has filed for bankruptcy than a business that has not, due to the restrictions imposed on the debtor by the Bankruptcy Code, the involvement of the United States trustee or bankruptcy administrator in overseeing the administration of cases, and immediate access to the bankruptcy court to address many types of wrongdoing by debtors.

(Footnote 10 return)
The intellectual property exception has several problems. First, it ignores the possibility that the debtor is the intellectual property licensor rather than the licensee. If the licensor cannot assume the contract, the nondebtor licensee may be deprived of rights, except to the extent protected under section 365(n). Second, if the debtor is the licensee, there is no reason why a technical prepetition default on a nonmonetary obligation, such as going dark or a conducting a going out of business sale, should justify forfeiting the debtor's access to the intellectual property as long any other defaults have been cured. If some additional protection is desired, the balancing test used in the amendment for executory contracts should be sufficient.

(Footnote 11 return)
S. 260 and H.R. 763 also increase family farmer eligibility and modify the treatment of certain government obligations.

(Footnote 12 return)
The latest national median family income figures available to the Conference are from 1997. The 1997 national median family income is $37,562 for a family of 2, $46,783 for a family of 3, $53,350 for a family of 4, $51,101 for a family of 5, $45,473 for a family of 6, and $42,001 for a family of 7 or more. The 1997 national median household income for one earner is $29,780. *See* U.S. Department of Commerce Economics and Statistics Administration, Bureau of the Census, *Money Income in the United States: 1997*, Current Population Reports; Consumer Income, P60–200.

(Footnote 13 return)
This income threshold is based on "household" income while the threshold for the trustee's requirement to bring motions uses the higher "family" income. The latest median household figures are from 1997. The national median income is $18,762 for a household of 1, $39,343 for a household of 2, $47,115 for a household of 3, $53,165 for a household of 4, $50,407 for a household of 5, $46,465 for a household of 6, and $42,343 for a household of 7 or more. *See* U.S. Department of Commerce Economics and Statistics Administration, Bureau of the Census, *Money Income in*

the United States: 1997, Current Population Reports; Consumer Income, P60–200.

(Footnote 14 return)
The National Bankruptcy Conference and the Commercial Law League of America have formulated a revised version of the small business provisions in Title IV that addresses many of the problems identified in this section by section analysis. The revised small business provisions are attached as Appendix E to the National Bankruptcy Conference March 17, 1999 testimony to the Subcommittee on Commercial and Administrative Law of the House Judiciary Committee.

(Footnote 15 return)
Attached is a chart detailing the differences between the H.R. 3150 as originally passed by the House and the Conference Report on H.R. 3150.

(Footnote 16 return)
Last Congress the Subcommittee heard testimony from Stuart Feldstein who examined many of these issues in depth.

(Footnote 17 return)
Consumer Bankruptcy: Annual Bankruptcy Debtor Survey. Visa Consumer Bankruptcy Reports, August 1997.

(Footnote 18 return)
The Personal Bankruptcy Crisis, 1997. SMR Research Corporation, 1997.

(Footnote 19 return)
U.S. Census Bureau, "Money Income in the United States: 1997", P60-200 p. vi (September, 1998). Notwithstanding a prosperous economy, the Census Bureau reports that the median income for all households in 1997 ($37,005) was almost identical to the median income for all households in 1989 ($37,303). *Id.* By contrast, the level of revolving consumer credit in the United States more than doubled between January, 1986 and December, 1991, and doubled again between January, 1992 and August, 1998. Federal Reserve Statistical Release G.19 at www.bog.frb.fed.us/release/G19/hist. Given these numbers, it is not surprising that the number of nonbusiness bankruptcy filings has doubled since 1990. *See* Non-Business Bankruptcy Filings by Chapter 1990-1998 (3rd Quarter) <http://www.abiworld.org/stats/1990nonbuschapter.html.

(Footnote 20 return)
Section 603 of H.R. 833 requires that the following documents be filed:

(Footnote 21 return)
The data in Exhibit 2 was extracted from the case surveys by my law clerk and judicial extern.

(Footnote 22 return)
The median model year of all cars was only slightly higher in most of the surveys.

(Footnote 23 return)
Congressional Budget Office, "Cost Estimate: H.R. 3150—Bankruptcy Reform Act of 1998" (June 5, 1998).

(Footnote 24 return)
H.R. 833 presently vests in the chapter 7 panel trustees the mandatory duty of reviewing all chapter 7 cases and bringing motions under section 707(b). The chapter 7 trustees are certainly capable of performing this task, but have little incentive to do so, since their prime function is to recover assets in chapter 7 cases, not move people into chapter 13 or out of the system altogether. More importantly, while there may be a way to compensate them for their efforts in converting or dismissing the 3.6% of the debtors who are abusing the system, how do we compensate them for the time they will have to spend on the other 96.4% of the cases where there is no abuse? No simple solution to this problem comes to mind.

(Footnote 25 return)
See 28 U.S.C. §586(a)(5).

(Footnote 26 return)
See 28 U.S.C. §586(a)(3)(A)(I). 28 C.F.R. §0.37 provides for the appointment of the Director. 28 C.F.R. §0.38 states that the Director shall assist the Attorney General and Deputy Attorney General "in supervising and providing general coordination and assistance to the United States Trustees", and perform other duties assigned to her.

(Footnote 27 return)
See M. B. Culhane & M. M. White, "Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors," p.33 (March 8, 1999).

(Footnote 28 return)
The authors are Professors of Law at Creighton University School of Law. This project was funded by a grant from the American Bankruptcy Institute's Endowment Fund. The underlying database was built for a different project funded by the National Conference of Bankruptcy Judges, the Bankruptcy Section of the Nebraska State Bar Association and Creighton University Law School. Computer programming and statistical analysis were done by David Van Dyke of Van Dyke Consulting, Inc. He cheerfully responded "It can be done" to our endless requests for further analyses. In addition, Professor Gary Neustadter's comments on an early draft of this article improved it greatly. We are grateful to them all.

(Footnote 29 return)
Elizabeth Warren, *The Bankruptcy Crisis*, 73 **Ind. L.J.** 1079, 1079–84 1998); Richard E. Coulson, *Substantial Abuse of Bankruptcy Code Section 707(b),* 52 **Consumer Fin. Q. Rep.** 261, 286 (1998); Diane Ellis, The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and the Personal Bankruptcy Rate, Bank Trends (Federal Deposit Insurance Corp, Washington, D.C. 98–05 March 1998); Lawrence M. Ausubel, *Credit Card Defaults, Credit Card Profits, and Bankruptcy*, 71 **Am. Bankr. L.J.** 249 (1997); William Whitford, *Changing Definitions of Fresh Start in U.S. Bankruptcy Law*, 20 **J. Consumer Pol.** 179, 192–93 (1997); *The Increase in Personal Bankruptcy and the Crisis in Consumer Credit: Hearing Before the Subcomm. on Admin. Oversight and the Courts of the Senate Comm. on the Judiciary*, 105th Cong. 39 (1997) (statement of Kim J. Kowalewski, Macroeconomic Analysis Division, Congressional Budget Office).

(Footnote 30 return)
The Bankruptcy Reform Act of 1999, H.R. 833, §102, 106th Cong. (1999); A Bill to Amend Title 11 of the U.S. Code to Modify the Application of Chapter 7 Relating to Liquidation Cases, H.R. 333, 106th Cong. (1999); Bankruptcy Reform Act of 1998, H.R. 3150, 105th Cong. §101 (1998); The Consumer Lenders and Borrowers Accountability Act of 1998, H.R. 3146, 105th Cong. §8 (1998); Consumer Bankruptcy Reform Act of 1997, S. 1301, 105th Cong. §102 (1997); Responsible Borrower Act of 1997, H.R. 2500, 105th Cong. §101 (1997).

(Footnote 31 return)
A recent account of the consumer credit industry's long campaign to restrict access to Chapter 7 appears in Richard E. Coulson, *Substantial Abuse of Bankruptcy Code Section 707(b)*, 52 **Consumer Fin. Q. Rep.** 261, 264–74 (1998). Section 707(b) allows dismissal of Chapter 7 cases for "substantial abuse," which in many courts involves determining whether the debtor could repay in Chapter 13. Thus, we have had one form of means-testing since 1984.

(Footnote 32 return)
The term "can-pay" comes from Elizabeth Warren, *The Bankruptcy Crisis, supra* note 1, at 1090 n.48.

(Footnote 33 return)
Means-testing is critically examined in Jean Braucher, *Increasing Uniformity in Consumer Bankruptcy: Means Testing as a Distraction and the National Bankruptcy Review Commission's Proposals as a Starting Point*, 6 **Am. Bankr. Inst. L. Rev.** 1 (1998); Gary Klein, *Means Tested Bankruptcy: What Would It Mean?* ***U. Mem. L. Rev.*** *711 (1998); Elizabeth Warren*, *The Bankruptcy Crisis, supra* note 1; Hon. Eugene R. Wedoff, An Analysis of the Consumer Bankruptcy Provisions of H.R. 3150, <http://www.abiworld.org.legis/bills/98julhr3150.html> at 4–5 (July 16, 1998).

(Footnote 34 return)
Of course, most liens survive a Chapter 7, so a debtor who wants to keep property subject to a lien must pay secured creditors post-discharge to avoid foreclosure. In addition, many debts are nondischargeable in Chapter 7; tax, support, student loan, tort and various other creditors may pursue debtors despite a Chapter 7 discharge. *See* 11 U.S.C. §523 (1994) (listing nondischargeable debts).

(Footnote 35 return)
Richard E. Coulson, *Substantial Abuse of Bankruptcy Code Section 707(b), supra* note 3; Wayne R. Wells, *et al.*, *The Implementation of Bankruptcy Code Section 707(b): The Law and the Reality*, 39 **Clev. St. L. Rev.** 15 (1991); Karen Gross, *The Debtor as Modern Day Peon: A Problem of Unconstitutional Conditions*, 65 **Notre Dame L. Rev.** 165, 174 n.54 (1990).

(Footnote 36 return)
Ernst & Young, Chapter 7 Bankruptcy Petitioners' Ability to Repay: the National Perspective, 1997 <http://www.ey.com/tax/eyecon/bankruptcy.asp> (March, 1998) [hereinafter E & Y]; Ernst & Young, Chapter 7 Bankruptcy Petitioner's [sic] Ability to Repay: Additional Evidence from Bankruptcy Petition Files (February, 1998) (available on the Ernst & Young website above); WEFA, The Financial Costs of Personal Bankruptcy (February, 1998) (unpublished manuscript on file with authors); John M. Barron & Michael E. Staten, Personal Bankruptcy: a Report on Petitioner's Ability-to-Pay (Oct. 6, 1997) (unpublished manuscript on file with authors); VISA, Consumer Bankruptcy: Bankruptcy Debtor Survey (July, 1996) (unpublished manuscript on file with authors); VISA, Bankruptcy Petition Study (June, 1997) (unpublished manuscript on file with authors).

(Footnote 37 return)
E & Y's March report concluded that these results "are consistent" with the firm's February 1998 report, as well as with other VISA-funded studies by WEFA and the Credit Research Center. E & Y, *supra* note 8, at 16.

(Footnote 38 return)
Bankruptcy Reform Act of 1998, H.R. 3150, 105th Cong. §101 (1998). E & Y, *supra* note 8. On February 24, 1999, means-testing legislation was agains introduced in the House. The Bankruptcy Reform Act of 1999 is identical to the

Conference Report of H.R. 3150 which passed the House late in the 105th Congress. <http://www.abiworld.org/headlines/99feb25.html> at 1 (February 25, 1999).

(Footnote 39 return)
Id. at 12.

(Footnote 40 return)
The authors of E & Y's March report informed us that 11% of their sample were can-pays when they retested at 100% of the medians under the House-passed version of H.R. 3150. Telephone conversation with Dr. Thomas Neubig and Mr. Gautam Jaggi, Jan. 28, 1999. E & Y have not issued a written report on these revisions.

(Footnote 41 return)
See Elizabeth Warren, *The Bankruptcy Crisis, supra* note 1, at 1091–94 (1998); Gary Klein, *Means Tested Bankruptcy: What Would It Mean? supra* note 5, at 713–28; General Accounting Office, Personal Bankruptcy, The Credit Research Center Report on Debtors' Ability to Pay (1998).

(Footnote 42 return)
See U.S. Gen. Accounting Office, GAO/T–GGD–98–79, Personal Bankruptcy: The Credit Research Center and E & Y Reports on Debtors' Ability to Repay at 6–7 (1998). The GAO also faulted these studies for reliance on unaudited data from Chapter 7 court files. *Id.* To that, we must also plead guilty. At present, no other data are available at reasonable cost.

(Footnote 43 return)
Marianne B. Culhane & Michaela M. White, Preliminary Results of the Bankruptcy Reaffirmation Project (October, 1998) [hereinafter Reaffirmation Project] (unpublished manuscript on file with authors). Appendix B describes our sample design as well as data collection and coding.

(Footnote 44 return)
Bankruptcy Reform Act of 1998, H.R. 3150, 105th Cong. §101 (1998).

(Footnote 45 return)
The absolute number is 37 can-pay debtors from a sample of 1041 cases, or 3.55%. When weighted to reflect the total number of Chapter 7 cases filed in each sample district in 1995, the weighted percentage is also 3.55%. See Table 5, *infra* at **XX**. The weighting process is outlined in note 33, *infra*.

(Footnote 46 return)
Congressional Budget Office Cost Estimate, H.R. 3150: Bankruptcy Reform Act of 1998 (reported June 5, 1998) <http://www.cbo.gov/showdoc.cfm?index=>.

(Footnote 47 return)
H.R. 3150 expresses these tests as follows:

(Footnote 48 return)
We have weighted the results of H.R. 3150's tests to reflect the total number of Chapter 7 cases filed in 1995 in each

of our seven sample districts. *See* note 33 *infra* for an explanation of the weighting procedure. Other findings, however, are unweighted unless otherwise stated.

(Footnote 49 return)
See supra, text accompanying note 17.

(Footnote 50 return)
See supra, text accompanying note 12.

(Footnote 51 return)
E & Y, *supra* note 8, at 18, 25–26.

(Footnote 52 return)
E & Y's sample includes 2,200 cases filed in 1997, with cases from all federal judicial districts in the proportion to which each district's total Chapter 7 filings bears to total national Chapter 7 filings in 1997. Our sample is described in detail in Appendix B.

(Footnote 53 return)
In that regard, H.R. 3150's requirement that income be evidenced not only by recent pay stubs but also by copies of tax returns for the three years prior to bankruptcy is problematic. Section 406(c)(1), H.R. 3150, as passed by the House in June, 1998, requires each Chapter 7 debtor to provide "copies of all Federal tax returns . . . filed by the debtor for the 3 most recent tax years preceding the order for relief." Judge Wedoff, in his critique of H.R. 3150, emphasizes the "significant burdens" that production of tax returns and pay stubs will impose. "Both the difficulty and cost of assembling the required information and the intrusion on privacy would act as substantial barriers to good faith bankruptcy filings." Wedoff, *supra* note 5, at 30–31.

(Footnote 54 return)
H.R. 833 §102(b)(2,5), 106th Cong. (1999). H.R. 3150 §102(b)(2,5) (Conference Report on H.R. 3150, Oct. 30, 1998, 105th Cong.); *see supra* note 10.

(Footnote 55 return)
The bill provides "'current monthly total income' means the average monthly income from all sources derived which the debtor, or in a joint case, the debtor and the debtor's spouse, receive without regard to whether it is taxable income, in the six months preceding the date of determination, and includes any amount paid by anyone other than the debtor, or in a joint case, the debtor and the debtor's spouse, on a regular basis to the household expenses of the debtor or the debtor's dependents and in a joint case, the debtor's spouse if not otherwise a dependent." H.R. 3150 §101(1)(A).

(Footnote 56 return)
E & Y, *supra* note 8, at 29. The current Official Bankruptcy Forms, however, require disclosure only of monthly gross income at time of filing and annual gross income for the three years prior to filing.

(Footnote 57 return)
E & Y, *supra* note 8, at 29.

(Footnote 58 return)
H.R. 3150 §101(1)(B). The Census Bureau's website displays the national median income tables at <http://www.census.gov/hies/income/histinc/>. As of January 1 of any year, the Census Bureau has information only for the second year before that date. In times of high inflation, this could substantially increase the number of cases subject to individualized scrutiny under the second and third tests. *See* Wedoff, *supra* note 5, at 4–5.

(Footnote 59 return)
For households of one, the appropriate median is that for "households with one earner" rather than "households of one person." H.R. 3150 §101(4). *See* Ed Flynn and Gordon Bermant, *Measuring Means-Testing: It's All in the Words*, **American Bankruptcy Institute Journal** at 1 (September, 1998). The Median Income for Households of One (Table H–11) is substantially lower than that for Households with One Earner (Table H–12). In 1993, the figures were $16,065 and $25,560 respectively.

(Footnote 60 return)
For households of two or more, we used medians from Table F–8, Size of Family. H.R. 3150 allows families of five or more to use the highest median income for a family of the same or lesser size because the actual median incomes for families of five or more are lower than those for families of four. H.R. 3150 §101(4).

(Footnote 61 return)
For this article, we weighted the results to reflect the number of nonbusiness Chapter 7 cases filed in each district. For that reason, the percentage results differ slightly from the unweighted results in our earlier paper on this project. Culhane & White, *supra* note 17.

(Footnote 62 return)
The earlier version also used a different and much lower median for households of one, which amounted to 33.2% or 346 cases in our sample. *See supra*, note 31 for more on this point.

(Footnote 63 return)
We retested our sample against 75% of the 1993 equivalents to the medians used by E & Y in the March, 1998 report. Forty-nine percent of our sample met the threshold. E & Y, to our knowledge, has not disclosed the percentage of their sample passing the first or second tests when applying 100% of the national median income figures. They have only indicated that 11% of their sample passed all three tests of H.R. 3150. *See supra* note 12.

(Footnote 64 return)
See supra note 33 for discussion of weighting.

(Footnote 65 return)
The total number of nonbusiness Chapter 7 cases filed in 1995 in each sample district is displayed in Table 2 in the column titled "Total Ch. 7 Filings in 95."

(Footnote 66 return)
See supra note 32.

(Footnote 67 return)
The bill defines necessary payments as follows:

(Footnote 68 return)
11 U.S.C. §506(a), 1325(5) (1994).

(Footnote 69 return)
H.R. 3150 §124 (Conference Report on Bankruptcy Reform Act of 1998, Oct. 30, 1998, 105th Cong.). The Bankruptcy Reform Act of 1999 has an identical provision. H.R. 833, §124, 106th Cong. (1999).

(Footnote 70 return)
Id. An earlier version more reasonably limited the no-cram-down rule to goods purchased within six months before the case was filed. H.R. 3150 §128 (as passed by the House on June 10, 1998). Both versions also provide that the property shall be valued at the full unpaid balance in any subsequent bankruptcy case filed by the debtor within two years after the current case was filed. *Id.*

(Footnote 71 return)
H. Gray Burks, IV, *Rethinking the Eradication of Cram Down—Changing "Cram Down" to "Cram Up*," Norton Bankruptcy Law Adviser 10, 11 (December, 1998).

(Footnote 72 return)
The Collection Financial Standards are displayed on the IRS website. *See* <http://www.irs.ustreas.gov/prod/ind-info/coll-stds/>; IRS Manual 5323.433 (rev. 1995).

(Footnote 73 return)
See supra note 44.

(Footnote 74 return)
Id.

(Footnote 75 return)
E & Y treated the Transportation Ownership Allowance as a maximum, as discussed at text accompanying notes 51–57 *infra*.

(Footnote 76 return)
We converted 1997 to 1994 dollars by multiplying 1997 dollars by the Consumer Price Index (CPI) for 1994 divided by the CPI for 1997. The CPI for 1994 is 148.2 and for 1997 is 160.5. This yields a formula of: $100 x (148.2/160.5) = $92.34. Council of Economic Advisors, Economic Indicators (May, 1998).

(Footnote 77 return)
The IRS in fact treats only the Food and Clothing category as an allowance without reference to taxpayers' actual expenses. The Housing and Utilities and Transportation categories set a dollar maximum, but the taxpayer is allowed only actual expenses up to the maximum. We, like E & Y, interpreted H.R. 3150 to treat all three of these categories as allowances.

(Footnote 78 return)
The CFS expense allowances for the most part are adjusted for regional, sometimes down to county-level, cost-of-living. In his analysis of H.R. 3150, Judge Eugene Wedoff raised the problem of the CFS allowances being unduly restrictive, in Cook County, Illinois, where the range in residential rent is huge. *See* Wedoff, *supra* note 5, at 6–7.

(Footnote 79 return)
See IRS Manual 5323.433 (rev. 1995).

(Footnote 80 return)
Id.

(Footnote 81 return)
Id.

(Footnote 82 return)
H.R. 3150 §101(4).

(Footnote 83 return)
At least 50 more cars were leased. Reaffirmation Project Data, on file with the authors.

(Footnote 84 return)
The debtors may have bought these as used cars or pledged them as collateral for nonpurchase-money loans.

(Footnote 85 return)
Jill Michaux, a member of the Board of Directors of the National Association of Consumer Bankruptcy Attorneys, informed us that, even under current 36-month Chapter 13 plans, car repairs and replacement are a constant problem. She also said Chapter 13 debtors find it particularly difficult to buy a newer vehicle because car dealers are unwilling to follow the procedure under 11 U.S.C. §1305 to incorporate their claim into an ongoing Chapter 13 plan. Telephone conversation between Marianne Culhane and Jill Michaux, Friday, January 8, 1999.

(Footnote 86 return)
A perverse incentive to load up on secured debt prior to filing is built into H.R. 3150, given that any increase in secured debt makes it less likely the debtor will fall into the can-pay category and be dismissed from Chapter 7. Remember that under the bill, nonhousing secured debt is assumed to be repaid 100% in 60 months. H.R. 3150 §101(4).

(Footnote 87 return)
See IRS Manual at 5323.433 (rev. 1995).

(Footnote 88 return)
E & Y, *supra* note 8, at 30–32.

(Footnote 89 return)

Where comparison with the claim amount showed the mortgage would be paid off in less than 60 months, we first multiplied the monthly payment by .85 to remove tax and insurance, then grossed up the claim amount by 10% to account for additional interest, divided the sum by 60 to come up with a level monthly payment, and allowed that rather than the scheduled monthly payment. *See id.* at 31.

(Footnote 90 return)
IRS Manual at 5323.433 (rev. 1995).

(Footnote 91 return)
The bill requires:

(Footnote 92 return)
One difficulty in adapting the CFS for use in H.R. 3150 means-testing is possible duplication between the CFS Other Necessary Expense Category and H.R. 3150's extraordinary expense deduction described above.

(Footnote 93 return)
Pub. L. No. 105–183 (1998).

(Footnote 94 return)
Id.

(Footnote 95 return)
H.R. 3150 §118(d) (emphasis added) (as passed by the House on June 10, 1998). This section did not become part of the Conference Report of H.R. 3150 which passed the House late in the 105th Congress. Nor is it part of H.R. 833, 106th Cong. (1999). However, the interplay of the Tithing Act and the CFS arguably yields the same result.

(Footnote 96 return)
Thomas J. Yerbich, H.R. 3150 After the Impact of the Tithing Law-Alice in Wonderland? <http://www.abiworld.org/abidata/online/newslet/98yerbich2.html>. Debtors and their counsel should remember, however, that the Tithing Act does not prevent a claim that the donation was a transfer made "with actual intent to hinder, delay or defraud . . ." under 11 U.S.C. §544(b), 548(a)(1) and 727(a). Steven J. McCardell, *The Religious Liberty and Charitable Donation Protection Act of 1998,* ***Norton Bankruptcy Law Adviser*** *8, 9 (Sept. 1998). Legislative history suggests that prior patterns of conduct may be relevant, and that large eve-of-bankruptcy donations from first-time givers could raise an inference of intent to defraud. House Report 105–556 (1998). See also* In re Buxton, 228 B.R. 606 (Bankr. E.D. La. 1999) (qualified contributions subject to "reasonably necessary" expense limits even after Tithing Act).

(Footnote 97 return)
This point is forcefully made by the Chief Bankruptcy Judge of the Central District of California. *See* Geraldine Mund, Sample Debtor Summary (1998) (unpublished manuscript on file with authors).

(Footnote 98 return)
Home mortgage payments frequently include tax and insurance escrow amounts in addition to principal and interest portions. We, like Ernst and Young, compensated for this by multiplying home mortgage payments by 85%, and treating the result as principal and interest. E & Y, *supra* note 8, at 31.

(Footnote 99 return)
H.R. 3150 §101(4).

(Footnote 100 return)
Of course, the recent trend to seven-year and even ten-year car loans casts doubt on this assumption.

(Footnote 101 return)
E & Y, *supra* note 8, at 31–32.

(Footnote 102 return)
Neither we nor E & Y allowed interest on Priority Claims, although in fact such claims are entitled to be paid present value as of the date of confirmation of the plan. 11 U.S.C. §1325(a) (1994). Stretching these claims out for 60 months will give this provision real impact. Omitting this calculation of course leads to overstatement of repayment capacity.

(Footnote 103 return)
H.R. 3150 §101(4).

(Footnote 104 return)
11 U.S.C. §507(a)(1) (1994).

(Footnote 105 return)
Chapter 13 attorney fees and extension of credit practice is described in Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 **Amer. Bankr. L.J.** 501, 545–49 (1993).

(Footnote 106 return)
E & Y, *supra* note 8, at 18, 26.

(Footnote 107 return)
The Chapter 13 trustee is required to "collect [a] percentage fee from all payments received by such individual under plans . . . under chapter . . . 13. . . ." 28 U.S.C. §586(e)(2) (1994).

(Footnote 108 return)
This figure was obtained from the Executive Office of the United States Trustee.

(Footnote 109 return)
Debtors are commonly allowed to make certain large payments directly to creditors and thus escape the trustee's percentage fee on those payments. When a debtor is curing arrearages on a home mortgage or other secured debt, cure payments must be made though the plan and thus are subject to the trustee's fee. *See* Michaela M. White, *Direct Payment Plans*, 29 **Creighton L. Rev.** 583 (1996).

(Footnote 110 return)

See 11 U.S.C. §330(a)(4)(B) (1994) (allowance of fees to Chapter 13 debtor's counsel); 11 U.S.C. §503(b)(2) (1994) (administrative expense priority for fees to debtor's counsel).

(Footnote 111 return)
National Association of Consumer Bankruptcy Attorneys Survey on Compensation 4 (1996). *See also* American Bankruptcy Institute, National Report on Professional Compensation in Bankruptcy Cases 172 (1991) (the average Chapter 13 fee in 1991 was $820). Jean Braucher, *supra* note 5, at 547–48 (1991–92 Chapter 13 fees ranged from $650 to $1,500).

(Footnote 112 return)
H.R. 3150 would use the average monthly gross income for the six months prior to the petition. H.R. 3150 §101(1). As explained in text accompanying notes 24–28 above, both we and E & Y substituted current monthly gross income from Schedule J.

(Footnote 113 return)
Id. at §101(4).

(Footnote 114 return)
Id.

(Footnote 115 return)
E & Y, *supra* note 8, at 10. The 17% is the outcome when E & Y used 75% of the national median. To our knowledge, E & Y has not disclosed the percentage of their sample that passed the Projected Monthly Net Income test when they applied 100% of the relevant national median income to their sample debtors. *See supra* note 34.

(Footnote 116 return)
See supra note 32 for discussion of weighting.

(Footnote 117 return)
H.R. 3150 §101(4). As others have noted, this test in some ways rewards those with large unsecured debt relative to income and pushes into Chapter 13 those prudent or fortunate enough to have less unsecured debt relative to income. *See* Wedoff, *supra* note 5, at 7–8. The House-Senate Conference Report on H.R. 3150 §102 (October, 1998) and H.R. 833 §102 avoid this paradox by setting the third test in the alternative. Both would treat a debtor as a can-pay if Projected Monthly Net Income was sufficient to pay the lesser of $5,000 ($83.33 a month if one ignores the trustee's fee) or 25% of general unsecured debt.

(Footnote 118 return)
We calculated total nonpriority debt by adding Schedule F claims to the parts, if any, of Schedule E claims not entitled to priority.

(Footnote 119 return)
Dr. Thomas Neubig and Mr. Gautam Jaggi, two of the authors of E & Y's March, 1998 report, confirmed that 11% of their sample were can-pays at 100% of the median. *See supra* note 12.

(Footnote 120 return)
See supra note 33 for discussion of weighting.

(Footnote 121 return)
E & Y, *supra* note 8, at i.

(Footnote 122 return)
Id.

(Footnote 123 return)
$35,303 is the equivalent in 1997 dollars of the median unsecured debt of can-pay debtors in our sample. We converted 1995 to 1997 dollars by multiplying the 1995 dollars by the CPI for 1997 divided by the CPI for 1995. The 1997 CPI was 160.5 and the CPI for 1995 was 152.4. This yields a formula of: $100 x (160.5/152.4) = $1.053. Council of Economic Advisors, Economic Indicators (May, 1998).

(Footnote 124 return)
GAO Report, *supra* note 14, at 6.

(Footnote 125 return)
Id. at 7.

(Footnote 126 return)
Of course, some will never convert to Chapter 13 in the first place, but dismissal from Chapter 7 does not guarantee that their creditors will be able to force them to repay.

(Footnote 127 return)
Congressional Budget Office Cost Estimate H.R. 3150: Bankruptcy Reform Act of 1998 (reported June 5, 1998) <http://www.cbo.gov/showdoc.cfm?index=>.

(Footnote 128 return)
Id.

(Footnote 129 return)
Some 40% (163 of 446) of the filed reaffirmations in our Reaffirmation Project's sample of 1,043 Chapter 7 cases were of debts scheduled as unsecured or not scheduled at all. Culhane & White, *supra* note 15, at 3. It is quite likely that there were a great many more unfiled reaffirmations in 1995. In late 1996 and 1997, the systematic practice of Sears, Federated Department Stores, GE Capital and other retailers of not filing reaffirmation agreements with the court came to light. Sears alone is estimated to have failed to file 187,000 reaffirmations from 1992–1997. Numerous class actions against these and other retailers based on this practice were filed and settled for upwards of $200 million. On February 9, 1999, a Sears spokesperson stated that it would plead guilty to bankruptcy fraud and pay a $60 million fine for unlawfully collecting debts that were not reaffirmed in accordance with 11 U.S.C. §524. Cliff Edwards, *Sears Agrees to Plead Guilty to Bankruptcy Fraud Pay $60 Million Fine, **Associated Press**, Chicago, February 9, 1999, at 1, available in Westlaw, West Group; Joseph B. Cahill, Sears Agrees to Plead Guilty to Charges of Criminal Fraud in Credit-Card Case, **Wall Street Journal** at page B–11 (2/10/99).*

(Footnote 130 return)
It is true that the number might have been slightly higher had all the required information been available. That is, the six-month average gross income plus the income of spouses where married debtors file individual, rather than joint, petitions.

(Footnote 131 return)
Here we characterize as "nonpriority unsecured" any debt appearing on Schedule F without regard to whether the claim was properly so scheduled. However, where debts clearly not entitled to priority (such as student loans) appeared on Schedule E as priority claims, we treat those debts as nonpriority unsecured claims.

(Footnote 132 return)
See Marianne Culhane and Michaela White, *supra* note 15.

(Footnote 133 return)
Circuits allowing debtor to retain without reaffirmation or redemption: In re Parker, 139 F.3d 668, 672–73 (9th Cir. 1998); In re Boodrow, 126 F.3d 43, 53 (2d Cir. 1997), *cert. denied* **XX** U.S. **XX** (1998); In re Belanger, 962 F.2d 345, 347–48 (4th Cir. 1992); and Lowry Fed. Credit Union v. West, 882 F.2d 1543, 1546–47 (10th Cir. 1989).

(Footnote 134 return)
Bankruptcy courts assign sequential docket numbers to cases in the order filed, without regard to the chapter in which the case is filed. The docket numbers take the format xx-xxxxx. The first two digits indicate the year of filing, the first digit to the right of the dash indicates the division within the district and the remaining four digits the sequence of filing within that division.

(Footnote 135 return)
David Van Dyke, formerly a Creighton University faculty member and now president of Van Dyke Consulting, Inc., of Omaha, Nebraska.

(Footnote 136 return)
See description *supra* in Part II.

(Footnote 137 return)
See the attached Appendix 2.

(Footnote 138 return)
See the attached Appendix 3.

(Footnote 139 return)
See the attached Appendix 4–6 for statistics on bankruptcy by credit union members.

(Footnote 140 return)
Testimony of Brian L. McDonell before Subcommittee on Administrative Oversight and the Courts (March 11, 1998). In 1997, Navy Federal Credit Union offered a VISA Classic credit card rate of 12.5 percent with a non-annual fee.

(Footnote 141 return)
Congressional Budget Office cost estimate, S. 1301 Consumer Bankruptcy Reform Act of 1998, as reported by the Senate Committee on the Judiciary on June 4, 1998.

(Footnote 142 return)
Ernst & Young, LLP, Chapter 7 Bankruptcy Petitioners' Ability to Repay: the National Perspective, 1997 (March 1998).

(Footnote 143 return)
Marianne B. Culhane and Michaela M. White, Means-Testing for Chapter 7 Debtors: Repayment Capacity Untapped? (December 1998).

(Footnote 144 return)
Ernst & Young, LLP, Chapter 7 Bankruptcy Petitioners' Ability to Repay: Additional Evidence from Bankruptcy Petition Files (February 1998); WEFA Group, The Financial Costs of Personal Bankruptcy (February 1998); John M. Barron and Michael E. Staten, Personal Bankruptcy: A Report on Petitioners' Ability-to-Pay (October 1997).

(Footnote 145 return)
United States General Accounting Office, Personal Bankruptcy: The Credit Research Center and Ernst & Young Reports on Debtors' Ability to Pay, Testimony Before the Subcommittee on Commercial and Administrative Law, Committee on the Judiciary U.S. House of Representatives (March 1998).

(Footnote 146 return)
Ernst & Young, LLP (February 1998). (The study found a weighted average of 11.8 percent of Chapter 7 bankruptcies filed in the four sample districts would be affected by the means-test provision. The degree of the impact ranged across the district from 8 to 14 percent.

(Footnote 147 return)
Culhane and White (December 1998).

(Footnote 148 return)
For example, Michelle J. White, "Why It Pays to File for Bankruptcy: A Critical Look at the Incentives Under U.S. Personal Bankruptcy Law and a Proposal for Change," The University of Chicago Law Review (Summer 1998).

(Footnote 149 return)
Barron and Staten (October 1997).

(Footnote 150 return)
See the attached Appendix 8 for the variation in state asset exemptions across seven districts examined by the Culhane and White report.

(Footnote 151 return)

U.S. General Accounting Office, Personal Bankruptcy: The Credit Research Center Report on Debtors' Ability to Pay (February 1998).

(Footnote 152 return)
U.S. GAO (February 1998).

(Footnote 153 return)
When a sample distribution is biased, the median is a more robust estimator than the mean. Mean and median converge only if the sample distribution is normal and unbiased.

(Footnote 154 return)
Internal Revenue Service, Collection Financial Standards. <http://www.irs.treas.gov/prod/ind—info/coll—stds/>.

(Footnote 155 return)
Judge Edith H. Jones and Todd J. Zywicki, "It's Time for Means-Testing," Brigham Young University Law Review (forthcoming).

(Footnote 156 return)
Based upon income data from the U.S. Census Bureau and probability of Chapter 7 bankruptcy filings per district, the income bias is roughly estimated to be 3.3 percent. Correcting the percentage of debtors passing the income test for this estimated bias decreases the percentage of debtors with less than median household income from 79 to 76.4%. This figure is further corrected for seven excluded cases (0.7% of the total), which brings the percentage down to 75.7%. Culhane and White's own calculation shows that the percentage of debtors with less than $50 in net income would be reduced from 17 to 13.5% if corrected for transportation expenses. Adding these figures together lead to an estimated 9.8 percent of debtors to be impacted by the means-testing. However, this estimate is based upon very rough calculation and it should be empirically tested using national data.

(Footnote 157 return)
Congressional Budget Office Cost Estimate (June 1998).

(Footnote 158 return)
WEFA Group (February 1998). (The study estimated that the Chapter 7 debtors held an average of $74,650 in total debts. However, the amount of debts held by the impacted debtors is likely to be higher than this average because of their higher income level. The estimated amount of total debts held by the impacted debtors is based upon the study's estimate.)

(Footnote 159 return)
Even if we assume that only 36 percent of chapter 13 petitioners complete their repayment plan as GAO (February 1998) pointed out, financial benefits of means-testing in terms of repayment of unsecured nonpriority debts alone, are still $2.2 billion, a significant amount. See the attached Appendix 10 for a graphical illustration of the repayment by the impacted debtors.

(Footnote 160 return)
See the attached Appendix 10 for a graphical illustration of the repayment by the impacted debtors.

(Footnote 161 return)
This study was funded by Visa U.S.A. and MasterCard International.

(Footnote 162 return)
Tom Neubig is Ernst & Young's National Director of Policy Economics and Quantitative Analysis, and Gautam Jaggi and Robin Lee are managers with Ernst & Young's Policy Economics and Quantitative Analysis Group.

(Footnote 163 return)
The needs-based provision modeled in this report is based on H.R. 833, the "Bankruptcy Reform Act of 1999", and is substantially different from the needs-based provision modeled in the March 1998 Ernst & Young report. See sections 2 and 3 of this report for more details.

(Footnote 164 return)
For example, the 1996 national median income for a family of four was $51,518. (U.S. Bureau of the Census, 1997) Accordingly, families of four would not be subject to creditor motions if their gross income was under $51,518. Families with more than four members receive an extra $583 for each additional family member. So a family of six would not be subject to creditor motions if their gross income was under $52,684 ($51,518 + $583 x 2).

(Footnote 165 return)
Administrative Office of the US Courts (1998). Total Fiscal Year 1998 non-business filings were 1.39 million, consisting of 997,000 Chapter 7 filings, 392,000 Chapter 13 filings, and about 1,000 Chapter 11 filings.

(Footnote 166 return)
Needs-based bankruptcy measures were passed by the House and the Senate in 1998, but a final vote on the House/Senate Conference Report was not taken in the Senate before the end of the legislative session. H.R. 833, introduced in the 106 th Congress, contains essentially the same needs-based provisions as the October 1998 House/Senate Conference Report to Accompany H.R. 3150.

(Footnote 167 return)
For example, while the 1996 national median income was $35,492 for all households; for a family of four, it was $51,518. (U.S. Bureau of the Census, 1997) Accordingly, families of four would be likely impacted if their gross income exceeded $51,518, and they had the ability to repay at least $5,000 or 25 percent of their unsecured non-priority debt over 60 months. The income threshold for families with more than four members increases by $583 for each additional family member. So a family of six could be subject to creditor motions only if their gross income was over $52,684 ($51,518 + $583 x 2).

(Footnote 168 return)
The sample had to be drawn separately for two time periods because data for the entire year were not available until mid-January 1998. The sample for the first 11 months of 1997 was completed during the week of January 5, 1998. The sample for December 1997 was finished on January 16, 1998.

(Footnote 169 return)
Not all districts had 500 Chapter 7 filings. When this occurred, the available number were selected. This initial sample was for potential later use in taking larger samples in certain target districts.

(Footnote 170 return)
About 95% of Chapter 7 filings nationally are "no-asset" cases. A "no-asset" case refers to the situation where there are no funds remaining to be dispersed to creditors, after the debtor is allowed to keep all exempt assets. To achieve 200 Chapter 7 "asset case" selections, the actual sampling rate was doubled over that applicable for the "no-asset" cases. This oversampling was done to draw enough cases to make comparisons between the two types of Chapter 7 filers. Petitions were weighted so that the results would reflect the appropriate mix of "asset cases" and "no-asset" cases.

(Footnote 171 return)
The second stage sample started out, effectively, as a stratified random sample by district with the selection probabilities all equal—that is, a self-weighting sample. The number of Chapter 7 asset cases selected was then doubled and the samples in the smaller districts were increased so that the minimum was 12. At this point, the sample was judged too large and a systematic subsample was taken after sorting by district, chapter, and month of filing—arriving at the final counts summarized in Table 1.

(Footnote 172 return)
Administrative Office of the U.S. Courts (1998). There was a net shortfall in coverage between the Visa BNS database and the official counts. The slight discrepancy involved, under three percent, is not believed to be an important limitation to the analyses carried out in this report. In the table, the adjustments for net incompleteness have been made by circuit. See Ernst & Young (1998b) for more discussion.

(Footnote 173 return)
A full description of the methodology for this determination is found in Appendix 2 of Ernst & Young (1998b). Basically, the usable sample consists of all original selections, except identified dismissals, for which there was enough information to do the calculations under H. R. 3150. Aside from a small number of identified dismissals, therefore, the cases excluded either were never obtained or were too incomplete to use.

(Footnote 174 return)
A detailed description of the methodology used for the repayment calculations is provided in Section 4.

(Footnote 175 return)
These figures understate the total debt repaid over the life of the loan. For example, a petitioner with a mortgage would likely continue to make payments after the five year period called for in the needs-based proposal.

(Footnote 176 return)
The impact of trustee fees is difficult to estimate because of widely different practices in different districts. Fees typically vary, with mortgage debts (and sometimes car payments) generally not included as part of repayment plans. Given the uncertainty associated with Chapter 13 trustee fees, the impact of such fees was estimated using different assumptions, and presented as a range. Fees were estimated at 5.6 percent of debt payments, based on the 1995 national average (American Bankruptcy Institute, 1998, based on information from the Executive Office of the United States Trustee). Applying this percentage to all debt repayments over 60 months excluding mortgage debt repayments of filers with more than $20,000 in real estate debt gives a high estimate of trustee fees of $249 million. However, many consumers will likely choose not to file bankruptcy if they can repay all their debts under the needs-based test, since they would not get any debt relief under bankruptcy. These filers would have to continue repaying their debts, but by not filing bankruptcy they would not incur any trustee fees. Assuming that all likely impacted filers with the ability to repay all their debts choose not to file for bankruptcy reduces the trustee fee estimate to $138 million. In addition, if all secured debts were kept outside the repayment plans, the estimate would drop further to $93 million.

(Footnote 177 return)
The needs-based provision uses family median incomes for families with more than two members, and uses the median income for households with one earner for single person households. For comparison purposes, household median income is preferable to family median income since family median income does not include single person households.

(Footnote 178 return)
The composition of expenses was not calculated for filers not impacted by the needs-based provision, since many of these filers have expenses in excess of income, or do not have enough income available to service all of their secured and priority debts. In these cases, the actual expenses of debtors is understated for comparison purposes in this section. See Section 3 for more details on the repayment methodology.

(Footnote 179 return)
See Ernst & Young (1998a and 1998b) for details. It should be noted that the methodologies used for the February 1998 and March 1998 estimates are not directly comparable, because of factors such as differences in data availability, and the different cities and years covered by the samples. In addition, the two previous Ernst & Young studies are not directly comparable to this report since they estimate the impact of earlier legislation, with a different needs based provision. See the appendices in Ernst & Young (1998a and 1998b) and Section 4 in this report for methodological details.

(Footnote 180 return)
The Georgetown study, Barron and Staten (1998), calculated the ability to repay non-housing non-priority debt, and used reported petitioner expenses rather than IRS standards.

(Footnote 181 return)
See American Bankruptcy Institute (1998) for further details.

(Footnote 182 return)
Appendix 2 in Ernst & Young (1998b) contains a full discussion of the procedures used in processing the petitions, and an assessment of the importance of sampling error. Here, attention is confined to conceptual clarifications.

(Footnote 183 return)
The repayment calculations include interest on back taxes and secured debt. See Section 4 for details.

(Footnote 184 return)
Two measures of income were examined for the analyses: current 1997 gross monthly income and income for calendar year 1996. The smaller (and hence more conservative) of these, 1997 current monthly income, was used as the starting point in the projections. As noted earlier, 10 percent of the 1997 Chapter 7 filers would likely have been required to file Chapter 13 under the H.R. 833. Using 1996 income, the fraction of the Chapter 7 filers likely impacted by the needs-based provision would have been over 14 percent.

(Footnote 185 return)
The methodologies used for estimating trustee fees are described in the "Debt Repayment Capacity" section. Three different methods were used, and though these methods do have some impact on the share of filers impacted, when rounded to the nearest integer, the estimate is that 10 percent of Chapter 7 filers are impacted, regardless of whether or

not trustee fees are included.

(Footnote 186 return)
See Internal Revenue Service (1997) for more details.

(Footnote 187 return)
The calculations assumed a debtor is a homeowner if the petitioner had home or second mortgage debt on Schedule D, and had real property on Schedule A that was either a primary residence or multiple family housing unit.

(Footnote 188 return)
The number of vehicles was obtained by taking the larger of the number of personal property items identified on Schedule B as a vehicle, and the number of secured debts identified on Schedule D as vehicle debt.

(Footnote 189 return)
Mortgage payments were multiplied by 85 percent to remove taxes and mortgage insurance from the payment amount. The outstanding mortgage debt amount does not include interest, so the amount was grossed up by 10 percent. The 10 percent gross up for accrued interest is the ratio of the remaining cumulative interest to outstanding principal for an 8 percent 30 year amortized mortgage with 2 to 3 years to maturity.

(Footnote 190 return)
The 10 percent future accrued interest on secured non-mortgage debt is the ratio of remaining cumulative interest to outstanding principal for a nine percent four year automobile loan with 2 years to maturity. The nine percent market interest rate was obtained from the *Federal Reserve Board Bulletin*, Federal Reserve Board (1997).

(Footnote 191 return)
The $1,281 average of total Chapter 13 attorney fees is based on an estimate of attorney compensation by the National Association of Consumer Bankruptcy Attorneys, as reported in American Bankruptcy Institute (1998).