BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2003, AND THE NEED FOR BANKRUPTCY REFORM

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

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TUESDAY, MARCH 4, 2003

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to call, at 2 p.m., in Room 2141, Rayburn House Office Building, Hon. Chris Cannon [Chairman of the Subcommittee] presiding.

Mr. CANNON. I want to thank you all for coming out today. I want to begin today's legislative hearing before the Subcommittee on Commercial and Administrative Law by extending a warm welcome to my colleague from North Carolina and my friend Mr. Watt, the Subcommittee's distinguished Ranking Member, as well as the other Subcommittee Members who we expect to join us over time, and also our witnesses today. It is my sincere hope that the inaugural hearing of the Subcommittee in the 108th Congress commences what will be a productive legislative agenda and a cooperative working relationship.

In that regard, it is particularly appropriate and timely that H.R. 975, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2003," is the focus of our first legislative hearing.

Today's hearing is especially timely, because just last month the Administrative Office of the United States Courts reported the number of bankruptcy filings filed during a 1-year period once again has broken all previous records. During calendar year 2002, nearly 1.6 million bankruptcy cases were filed, reflecting an increase of approximately 6 percent over the prior year. This has been growing faster than our economy and our population combined.

I guess as a backdrop, the Chairman of the Judiciary Committee Mr. Sensenbrenner introduced H.R. 975 with 50 original cosponsors last week. Representing the most comprehensive set of reforms to the bankruptcy system in nearly 25 years, H.R. 975 seeks to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and by ensuring that the system is fair for both debtors and creditors.

Besides consumer and business bankruptcy law reforms, H.R. 975 includes an extensive array of provisions ranging from implementing an entirely new form of bankruptcy relief to deal with the complexities of transnational insolvencies to extending special protections to family farmers and fishermen. H.R. 975 is yet a further perfection of legislation that has been the subject of intense congressional consideration and debate for nearly 6 years. It is essentially identical to the bankruptcy reform legislation that the House considered and passed less than 4 months ago on the last day of the 107th Congress by a vote of 244 to 116. Indeed, the House on not one, but on six separate occasions has registered its unqualified bipartisan support for this legislation's predecessors in the last three Congresses.

Arguably some may wonder why it is even necessary to hold a hearing on this legislation given this fact and especially in light of the fact that over the course of the last 3 Congresses, there have been at least 17 prior hearings on the subject of bankruptcy reform before this Subcommittee and the full Committee at which nearly 130 witnesses testified. Nevertheless, we are here today to embellish further the legislative record in support of bankruptcy reform. Today's hearing will also provide a valuable opportunity for those of us, like myself, who are new to this Subcommittee or who are new to the Congress, like my colleagues from the States of Tennessee, Texas and Florida, to acquaint ourselves with H.R. 975's proposed reforms, with the assistance of our excellent panel of witnesses.

It is my hope that today's hearing will serve as a forum for the expression of all views on all issues presented by H.R. 975. From my perspective it would be particularly useful for the witnesses to discuss whether the current bankruptcy law adequately deals with fraud and abuse, and whether the proposed reforms would assist those who are defrauded, as well as in the court system and law enforcement who are charged with ferreting out fraud and abuse in the bankruptcy system. It would also be useful to hear from our witnesses with respect to how abuse and fraud in the current bankruptcy system affects American businesses and our Nation's citizens generally, and why, given the current economic circumstances, the need for comprehensive bankruptcy reform is even greater.

[The prepared statement of Mr. Cannon follows:]

PREPARED STATEMENT OF THE HONORABLE CHRIS CANNON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF UTAH

I want to begin today's legislative hearing before the Subcommittee on Commercial and Administrative Law by extending a warm welcome to my colleague from North Carolina, Mr. Watt, the Subcommittee's distinguished Ranking Member, as well as to the other Subcommittee Members and our witnesses. It is my sincere hope that this inaugural hearing of the Subcommittee in the 108th Congress commences what will be a productive legislative agenda and cooperative working relationship.

In that regard, it is particularly appropriate and timely that H.R. 975, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2003," is the focus of our first legislative hearing. Today's hearing is especially timely because just last month, the Administrative Office of the United States Courts reported that the number of bankruptcy filings filed during a one-year period—once again—has broken all previous records. During calendar year 2002, nearly 1.6 million bankruptcy cases were filed, reflecting an increase of approximately 6 percent over the prior year.

Against this backdrop, the Chairman of the Judiciary Committee, Mr. Sensenbrenner, introduced H.R. 975 with 50 original cosponsors last week. Representing the most comprehensive set of reforms to the bankruptcy system in nearly 25 years, H.R. 975 seeks to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and by ensuring that the system is fair for both debtors and creditors. Besides consumer and business bankruptcy law reforms, H.R. 975 includes an extensive array of provisions ranging from implementing an entirely new form of bankruptcy relief to deal with the complexities of transnational insolvencies to extending special protections to family farmers and fishermen.

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Mr. CANNON. I now turn to my colleague Mr. Watt, the distinguished Ranking Member of the Subcommittee, and ask him if he has any opening remarks.

Mr. WATT. Thank you, Mr. Chairman. I want to, first of all, return the compliment and tell you how much I am looking forward to serving with you as the Chair of this Committee and serving in my capacity as the Ranking Member of the Subcommittee since this is our first official business of this term of Congress, and I think it is actually quite a tribute to you, Mr. Chairman, that there is a hearing taking place on the bankruptcy bill, because as I recall, 2 years ago one of the major complaints that we had was that the bill itself, without the benefit of a hearing for the new Members of the Committee or Subcommittee, went directly to the full Committee; no hearing at the Subcommittee level, no hearing at the full Committee level, and directly to markup. And some of us attributed that to the fact that the full Committee may have been trying to snub the Subcommittee Chairman.

So it looks like you have got enough power to get a hearing at this level, and I doubt that we will get to mark the bill up at this level, but at least we ought to be having some hearings, even though this bill appears to be pretty much the same bill that we dealt with last time.

I wish some of the new Members were here so that it would add power to my argument that a hearing such as this helps to inform the new Members of the Judiciary Committee, but maybe they have already made up their minds about it.

At a minimum this hearing allows me to put on the record a couple of things that I have put on the record before, and let me just put a couple of things on the record. Number one, I, like most everybody in America, thinks that there is abuse of the existing bankruptcy system, and that some reform is needed to try to rein in the abuse of the bankruptcy system.

Unlike many of my colleagues and the majority of the House, in fact, I do not believe this bill does a good job of doing that, and I want to restate again, much to the ire of my consumer friends and my creditor and debtor friends, my belief that a deal was made that minimizes the impact of this bill on fraud and abuse, and that deal basically allowed poor people to—whether they abuse the system or not, to go into one form of bankruptcy and not-so-poor people to go into another form of bankruptcy.

I think the means test is a terrible idea if the objective is to get to people who are abusing the system, because I think people are abusing the system whether they fall above the means test, whether they fall below the means test, and some people are not abusing the system whether they fall above the means test or below the means test level.

So if your purpose in doing bankruptcy reform was to do a reform bill that gets at fraud and abuse of the system, to go and set up a means test that automatically exempts some people from having to be responsible runs contrary, in my opinion, to that, and I have said it over and over again. But I won't belabor that. I don't have enough time to belabor it. I have said it over and over again. I continue to believe it. I think it is a terrible public policy decision to create a pauper's bankruptcy court and a higher-income bankruptcy court, and it is just bad public policy, and I will continue to say that throughout this process, even though virtually everybody is brought into this means test as a way of getting the bill passed.

So if we could go back and roll up our sleeves and really get at the problems that are besetting the bankruptcy system and do the hard work that would be necessary to come up with a system that would get at the abuse that is going on, and not just kind of pass for some people, I would be the first to roll up my sleeves, but I don't think that is going to happen this term. It didn't happen last term. It didn't happen the term before that, and so I think we are about to engage in a travesty on the public.

So with that, I will yield back whatever—I probably don't have any time—back, but I will yield it back anyway.

Mr. CANNON. Given your eloquence and our relationship, we didn't run the clock, although we will in the future.

Did you have a written statement you wanted to submit?

Mr. WATT. No, Mr. Chairman.

Mr. CANNON. Thank you.

Without objection, all Members may place their statements in the record at this point. Is there any objection?

Mr. NADLER. Is there any right to object that I can make a statement now?

Mr. CANNON. Certainly. Would you like to make an opening statement?

Mr. NADLER. Yes.

Mr. CANNON. May I just ask, who would like to make an opening statement?

Okay. Why don't you go ahead for 5 minutes, Mr. Nadler, and I shall—may—if I might just interject here. I shall tap when the light goes red, and if you could finish up, and also to our panel members who may not have done that before so that we can move the hearing expeditiously.

Thank you, and the gentleman is recognized for 5 minutes.

Mr. NADLER. Thank you, Mr. Chairman, and I am pleased to welcome you as our new Subcommittee Chair on the occasion of your first hearing at the helm of the Subcommittee. I would also like to thank you and Chairman Sensenbrenner for following regular order on this bill despite the great pressure that has been exerted in some corners to circumvent the normal process.

Although we have been considering bankruptcy legislation since the end of 1997, this bill has gone through many incarnations. Indeed, this is the first hearing that we have held since the beginning of the last Congress. During that time many things have happened. The economy has worsened. Whatever the reasons, that is a fact. People are hurting, and more than that, businesses are hurting. This bill will make it much harder to rescue a business as a going concern and to keep it from liquidation, and thus it will hurt many employees, communities, trade creditors and other businesses unnecessarily.

Making a discharge in bankruptcy more elusive will make it harder for consumers to get a fresh start and to continue to buy products. Household debt in this country has reached a record level. With that come more bankruptcies, but no serious economists would argue that a precipitous drop in consumer spending would help our economy.

Bankruptcy is a trade-off. Encouraged risk-taking in business allows distressed families to remain in the economy, creating demand for products businesses must sell to remain alive. Bankruptcy doesn't cause default any more than a hospital causes people to be sick.

Today's witnesses will stress the importance of making sure individuals understand the facts on bankruptcy before filing. The facts are—is that it is not a walk in the park. A debtor in Chapter 7 must give up all nonexempt assets in order to obtain a discharge. Secured debts must be paid, or the property is subject to foreclosure. The bankruptcy remains on the debtor's record for 10 years, and the debtor may not refile for 6 years under current law and 8 under the bill, which is 1 more year than is found in Deuteronomy. Apparently the banks who wrote this bill believe they know better than God on this one.

It can be hard to get a job, an apartment or a loan. As a Majority witness who had been a debtor told this Committee a few years ago, had she known the consequences of filing, she might not have done so.

No one on this Committee seriously believes that people should avoid debts that they can repay. The question, rather, is does this bill make sense. Members should ask themselves why the overwhelming majority of bankruptcy professionals, scholars, trustees, creditor lawyers, corporation lawyers and judges are appalled that

Congress is even contemplating this bill. There is a terrible disconnect between people who actually have to make the system function, regardless of their role or interest, who genuinely oppose this bill, and many people here in Congress and those who follow the demands of special interests who have a stake in some provision of this bill who generally think this is a great idea that requires no further investigation.

Over the years this Committee has heard from, among other people, Ken Klee, one of the leading bankruptcy scholars and business bankruptcy lawyers in the country, and former Republican bankruptcy counsel to this Committee. He has drafted Supreme Court briefs signed by Members of this Committee. Ralph Mabey, one of the most respected business bankruptcy lawyers in the country, has also testified against this bill. The late Lawrence King of NYU, an editor in chief of the authoritative Collier on Bankruptcy, has testified against this bill. Bob Waldschmidt on behalf of The National Association of Bankruptcy Trustees and Hank Hildebrand on behalf of the National Association of Chapter 13 Trustees have strongly criticized this bill in testimony, notwithstanding the fact that their organizations do not take formal positions on the bill.

We have heard from consumer rights organizations, women groups, child advocacy groups, unions, civil rights groups and every national bankruptcy organization in the country, who have testified that this bill will hurt consumers, will hurt families, will hurt children, yes, children, will hurt employees, minorities and the economy as a whole. It will raise costs to the system and will disrupt the efficient management of bankruptcy proceedings.

Mr. Chairman, despite the votes in this House, opposition to this bill is hardly marginal. In fact, outside the Beltway it is mainstream among the Nation's experts in bankruptcy. We have had many hearings over the years, but the considered opinion of people in the position to understand this technical subject matter has been systematically ignored.

Mr. Chairman, I know the leadership of this House is intent on moving the bill. I know it has been bought and paid for many times over by lobbying and campaign contributions. I know it is a priority of the President's, but we have a responsibility to the country to be deliberative, to take a careful look and to get it right despite the politics. Today we are having a hearing. I ask my colleagues to please listen and consider.

Thank you, Mr. Chairman. I yield back the balance of my time.

Mr. CANNON. I thank the gentleman from New York, Mr. Nadler.

[The prepared statement of Mr. Nadler follows:]

PREPARED STATEMENT OF THE HONORABLE JERROLD NADLER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Thank you, Mr. Chairman. I am pleased to welcome you as our new Subcommittee Chair on the occasion of your first hearing at the helm of this Subcommittee. I would also like to thank you and Chairman Sensenbrenner for following regular order on this bill despite the great pressure that has been exerted in some quarters to circumvent the normal process.

Although we have been considering bankruptcy legislation since the end of 1997, this bill has gone through many incarnations. Indeed, this is the first hearing that we have held since the beginning of the last Congress.

During that time, many things have happened. The economy has worsened. Whatever the reasons, that is a fact. People are hurting, and more than that, businesses are hurting. This bill will make it much harder to rescue a going concern and thus hurt communities employees, trade creditors, and other businesses unnecessarily.

Making a discharge in bankruptcy more elusive will make it harder for consumers to get a fresh start and continue to buy. Household debt has reached record levels. With that come more bankruptcies, but no serious economist would argue that a precipitous drop in consumer spending would help our economy.

Bankruptcy is a trade-off. Encourage risk-taking in business, allow distressed families to remain in the economy creating demand for products businesses must sell to remain alive.

Bankruptcy doesn't cause default any more than a hospital causes people to be sick. Today's witnesses will stress the importance of making sure individuals understand the facts on bankruptcy before filing. The facts are that it is not walk in the park. A debtor in ch. 7 must give up all non-exempt assets in order to obtain a discharge. Secured debts must be paid or the property is subject to foreclosure. The bankruptcy remains on the debtor's record for ten years and the debtor may not refile for six years under current law and eight under the bill, which is one more year than is found in Deuteronomy. Apparently the banks believe they know better than G-d on this one. It can be harder to get a job, an apartment, or a loan. As a majority witness who had been a debtor told this committee a few years, had she known the consequences of filing, she may not have done so.

No one on this Committee seriously believes that people should avoid debts they can repay. The question is rather, does this bill make sense. Members should ask themselves why the overwhelming majority of bankruptcy professionals, scholars, trustees, creditor lawyers, corporation lawyers, and judges are appalled that Congress is even contemplating this bill. There is a terrible disconnect between people who actually have to make the system function—regardless of their role or interests—oppose this bill, and here in Congress, the demands of special interests who have a stake in some provision in this bill generally think this is a great idea that requires no further investigation.

Over the years, this committee has heard from, among other people, Ken Klee, one of the leading bankruptcy scholars and business bankruptcy lawyers in the country, and former Republican bankruptcy counsel to this Committee. He has drafted Supreme Court briefs signed by members of this Committee. Ralph Maybe, one of the most respected business bankruptcy lawyers in the country, has also testified against this bill. The late Lawrence King of New York University, and Editor in Chief of the authoritative Colliers on Bankruptcy, has testified against this bill. Bob Walschmitt on behalf of the National Association of Bankruptcy Trustees and Hank Hildebrandt, on behalf of the National Association of Chapter 13 Trustees, have strongly criticized this bill in testimony notwithstanding the fact that their organizations do not take formal positions on this bill.

We have heard from consumer rights organizations, women's groups, child advocacy groups, unions, civil rights groups, and every national bankruptcy organization in the country that this bill will hurt consumers, families, children—yes, children—employees, minorities, and the economy. It will raise costs to the system, and disrupt the efficient management of bankruptcy proceedings.

Mr. Chairman, despite the votes in this House, opposition to this bill is hardly marginal. In fact, outside the beltway, it is mainstream among the nation's experts. We have had many hearings over the years, but the considered opinion of people in a position to understand this technical subject matter has been ignored.

Mr. Chairman, I know that the Leadership is intent on moving this bill. I know that it is a priority of the President's, but we have a responsibility to the country to be deliberative, to take a careful look, and to get it right no matter what the politics.

Today, we are having a hearing. Please, I ask my colleagues, please listen.

Mr. CANNON. The record should also reflect the presence of Mr. Delahunt from Massachusetts and Mr. Coble, from North Carolina. And my understanding is that Mr. Coble would like to be recognized for 5 minutes.

Mr. COBLE. Sixty seconds, Mr. Chairman.

Mr. Chairman, thank you for having the hearing, A. B, abuse of the system is a problem that needs to be addressed. This bill may or may not be the appropriate vehicle. I don't think this bill—this bill may not be as good as its proponents contend, probably not as bad as its critics claim; probably subtle shades of gray. I appreciate you having the hearing, Mr. Chairman. I have another hearing going on now that I am going to probably have to probably go back and forth, but in any event, thank you for recognizing me.

Mr. CANNON. I thank the gentleman, and we will be happy to try and accommodate your schedule for questioning if you would like to ask questions here.

Mr. Delahunt.

Mr. DELAHUNT. Just an inquiry, Mr. Chairman. Has there been a decision made as to when there would be a markup on this proposal?

Mr. CANNON. Let me answer the gentleman by first responding to what the gentleman from New York suggested. I can assure you that I am here to listen to the panel, and we are studying this issue. And I don't believe we have set a date for a markup, although I can assure the gentleman that Mr. Sensenbrenner and others would like to move it quickly. But we will be thoughtful in the process, I can assure you.

Mr. DELAHUNT. By quickly, I mean if I could just indulge my friend from Utah, are we talking a matter of weeks, or are we talking maybe after St. Patrick's Day?

Mr. CANNON. I don't know.

Mr. DELAHUNT. Don't know.

Mr. CANNON. Quickly means as soon as this body with regular order can move it. So we will have to wait and let you know as soon as something is decided.

I thank the gentleman.

Mr. NADLER. Mr. Chairman.

Mr. CANNON. Yes.

Mr. NADLER. Before we start the witnesses, may I be recognized for a unanimous consent request?

Mr. CANNON. Certainly.

Mr. NADLER. Thank you, Mr. Chairman. I ask unanimous consent at this time to place into the record the letter supported by 225 diverse organizations opposing the bill. I would also ask that the written testimony of former bankruptcy judge and former head of the U.S. Trustee Program, Jerry Patchan, explaining his views on the problems of the bill be entered into the record. And additionally, I would ask unanimous consent that two articles, one an op-ed by the Public Employees Credit Union in North Carolina disputing the CUNA position on this bill, and the second an article quoting former ABI president and creditor attorney Ricardo Kilpatrick stating the bill is a terrible mistake be placed in the record. As we say in Brooklyn, Mr. Chairman, these people aren't chopped liver. I urge all the Members of the Committee take their concerns very seriously.

Mr. CANNON. Without objection, so ordered.

Mr. NADLER. Thank you, Mr. Chairman.

[The material referred to follows:]

AFL-CIO
AMERICAN ASSOCIATION OF UNIVERSITY WOMEN
AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES
AMERICAN FRIENDS SERVICE COMMITTEE
AMERICANS FOR DEMOCRATIC ACTION
ASSOCIATION OF COMMUNITY ORGANIZATIONS FOR REFORM NOW (ACORN)
BUSINESS AND PROFESSIONAL WOMEN/ USA
CENTER FOR COMMUNITY CHANGE
CHILDREN'S FOUNDATION
CHURCH WOMEN UNITED
COMMISSION ON SOCIAL ACTION OF REFORM JUDAISM
CONSUMER FEDERATION OF AMERICA
CONSUMERS UNION
INTERNATIONAL BROTHERHOOD OF BOILERMAKERS
INTERNATIONAL UNION, UAW
LEADERSHIP CONFERENCE ON CIVIL RIGHTS
LUTHERAN OFFICE FOR GOVERNMENTAL AFFAIRS, ELCA
NAACP
THE NATIONAL ADVOCACY CENTER OF THE SISTERS OF THE GOOD SHEPARD
NATIONAL COMMUNITY REINVESTMENT COALITION
NATIONAL CONSUMER LAW CENTER
NATIONAL COUNCIL OF JEWISH WOMEN
NATIONAL COUNCIL OF WOMEN'S ORGANIZATIONS
NATIONAL ORGANIZATION FOR WOMEN
NATIONAL WOMEN'S LAW CENTER
NEIGHBORHOOD ASSISTANCE CORPORATION OF AMERICA
NETWORK, A NATIONAL CATHOLIC SOCIAL JUSTICE LOBBY
NOW LEGAL DEFENSE AND EDUCATION FUND
OWL, THE VOICE OF MIDLIFE AND OLDER WOMEN
PUBLIC JUSTICE CENTER
TRANSPORT WORKERS UNION
UNION OF NEEDLETRADE INDUSTRIAL AND TEXTILE EMPLOYEES, UNITE
UNITED STEELWORKERS OF AMERICA
U.S. PUBLIC INTEREST RESEARCH GROUP

March 3, 2003

The Honorable J. Dennis Hastert
Speaker
United States House of Representatives
Washington, D.C. 20515

The Honorable Nancy Pelosi
Minority Leader
United States House of Representatives
Washington, D.C. 20515

The Honorable James Sensenbrenner, Jr.
Chair, Judiciary Committee
United States House of Representatives
Washington, D.C. 20515

The Honorable John Conyers, Jr.
Ranking Member, Judiciary Committee
United States House of Representatives
Washington, D.C. 20515

Dear Representatives Hastert, Pelosi, Sensenbrenner and Conyers:

With the scheduling of a Judiciary subcommittee hearing tomorrow, the House has begun consideration of bankruptcy legislation for the fourth Congress in a row. Chairman Sensenbrenner has introduced legislation (H.R. 975) that is very similar to the 2002 bankruptcy conference report.

At a time when many Americans have been harmed by a very shaky economy and a massive wave of corporate scandals, moving forward mechanically with last year's conference report would be a mistake. The diverse organizations below—representing millions of vulnerable consumers--urge the House to make a fresh start on the bankruptcy issue and to reject legislation that would make it harder for the millions of families hit by financial misfortune to get back on track.

Rising bankruptcies are driven by economic difficulties. The timing of this bill couldn't be worse. Ninety percent of all bankruptcies are triggered by the loss of a job, high medical bills or divorce. The recession, the terrorist attacks and ongoing corporate scandals have taken their toll on many families. Unemployment is higher than it has been in over eight years. More than two million people have lost their state unemployment benefits. The number of Americans without health insurance jumped to more than 41 million in 2001 and has been climbing since.

This unbalanced bill would have a particularly destructive effect on working Americans who most need the bankruptcy safety net when misfortune strikes: women, who represent the single largest group in bankruptcy; African American and Latino homeowners, who are 500 percent more likely than white homeowners to find themselves in bankruptcy; laid-off workers, whose numbers are rising, and older Americans, who are now the fastest growing age group in bankruptcy.

There are several specific problems with the bill:

- **Imposes a rigid means test**. The bill sets up an inflexible formula to determine if an individual debtor is eligible to wipe away most of his or her debts in Chapter 7 bankruptcy. A debtor whose Chapter 7 case is challenged due to these assumptions will have to litigate the issue, an expense many debtors cannot afford. A bankruptcy judge would not be allowed to waive the means test even if the debtor is seeking bankruptcy relief because of some terrible circumstance beyond his or her control, like a medical emergency.

- **Endangers child support.** Despite extravagant claims to the contrary, the bill still threatens the welfare of children. If the parent who owes child support is the debtor, the bill will divert more money to other creditors (such as auto lenders and credit card companies) and allow more non-child support debts to survive bankruptcy. After the bankruptcy is over, the custodial parent will have to fight with creditors for the debtor's limited income.

- **Allows millionaires to continue to shelter their assets in mansions.** The bill will still allow some rich debtors in five states (those who have not been found to have committed certain types of wrongdoing, or those who have owned their home in the state longer than 40 months) to declare bankruptcy and keep homes of unlimited value.

- **Expands opportunities for creditor motions.** Creditors will be able to threaten debtors with new costly litigation and make it more likely that debtors who cannot afford to defend themselves in court will be coerced into giving up their legal rights.

- **Makes Chapter 13 plans to save homes and cars far more difficult.** Contrary to the supposed aim of encouraging more Chapter 13 payment plans, numerous provisions in the bill will make Chapter 13 much harder and less attractive. For many debtors, the bill will require five year plans (up from three years), assuring that the failure rate will be even higher than the current two-thirds who can't complete plans because of unexpected income or job loss.

- **Increases the likelihood that debtors will be evicted--even those who have caught up on back-rent.** The bill makes it easier for residential landlords to evict a tenant who is in bankruptcy.

- **Does nothing to curb reckless lending by credit card companies and other creditors. Reckless and predatory lending would go unchecked and could increase.** Abusive lending by creditors often contributes to bankruptcy. Moreover, by making it harder for debt-choked consumers to wipe away some debts when calamity hits, the bill would reduce the financial risk for lenders and encourage them to lower their credit standards even more and to solicit riskier consumers.

For the sake of the vulnerable Americans who would be harmed, the undersigned organizations urge you to reject the punitive bankruptcy restrictions in this bill. Our organizations do not oppose legislation targeted at bankruptcy abuse, whether by individuals or corporations, but this bill would harm families who are responsibly using the bankruptcy system. For more information, please contact Travis Plunkett at the Consumer Federation of America at 202-387-6121.

Sincerely,

AFL-CIO
American Association of University Women
American Federation of State, County and Municipal Employees
American Friends Service Committee
Americans for Democratic Action
Association of Community Organizations for Reform Now (ACORN)
Business and Professional Women/ USA
Center for Community Change
Children's Foundation
Church Women United
Commission on Social Action of Reform Judaism
Consumer Federation of America
Consumers Union
International Brotherhood of Boilermakers
International Union, UAW
Leadership Conference on Civil Rights
Lutheran Office for Governmental Affairs, ELCA
NAACP
The National Advocacy Center of the Sisters of the Good Shepard
National Community Reinvestment Coalition
National Consumer Law Center
National Council of Jewish Women
National Council of Women's Organizations
National Organization for Women
National Women's Law Center
Neighborhood Assistance Corporation of America
Network, A National Catholic Social Justice Lobby
NOW Legal Defense and Education Fund
Owl, the Voice of Midlife and Older Women
Public Justice Center
Transport Workers Union
Union of Needletrade Industrial And Textile Employees, UNITE
United Steelworkers of America
U.S. Public Interest Research Group

STATEMENT OF
JOSEPH PATCHAN

MARCH 4, 2003

Mr. Chairman, members of the Judiciary Committee, I am Joseph Patchan. I am a lawyer and have been a bankruptcy practitioner for many years. I appear here on my own behalf.

In the course of my professional career, I have served as a trustee and attorney for a trustee in bankruptcy cases. I have also served as a standing trustee in chapter 13 cases. I have represented both individual and business debtors in their cases, and have represented companies and creditors as well as committees in chapter 11 reorganization cases.

I have also been a bankruptcy judge, a member of the Bankruptcy Rules Committee of the Judicial Conference, and for a number of years served as Director of the Executive Office for United States Trustees in the Department of Justice.

In the time that the pending bankruptcy reform proposals have been before Congress, much has already been said and much has been written, both pro and con about the potential effect of the provisions presented in the Bankruptcy Reform Bill.

I don't intend to present a critique of the basic philosophy of the proposals to amend bankruptcy law as they are addressed to individual, consumer debtors in bankruptcy, you have heard a lot on that subject already.

I do intend to point to some omissions and imbalances in the Bill and particularly to question the timeliness of the Bill's proposals as drafted.

This Bill was written when the economy was growing during the 1990's. The Fed was raising interest rates in an effort to slow down the growth of the economy. This Bill fit that economic climate. It's effect is to slow down the economy.

One of the features of the Bill is to impress individual bankruptcy petitioners into chapter 13 of the Bankruptcy Code as an alternative to providing them with a discharge of their debts. Under chapter 13, a plan must be submitted providing that all of the debtor's "projected disposable income" for the next three years is to be applied to making payments under the plan. (Sec. 1325(b)(1)(B)). For the next three years then, the debtor will have no income to spend on anything except the bare necessities.

Bankruptcy filings are now being made at the rate of some 1.5 million filings per year. Estimating conservatively that about a third of that number will, under the provisions of this Bill be under chapter 13, that means that after the effect of the new law there will be 500 thousand American families who have no money to spend on anything except for necessities. And after two years, there will be a million families with nothing to spend except for necessities because the 500 thousand who filed the first year will still be paying all their "disposable income" to the chapter 13 trustee under their plans.

The number should level off after three years to 1.5 million families each year as plans reach completion. But that number presupposes that the annual filing rate holds steady. The filing rate has been increasing during each of the recent years.

Consider the effect of the withdrawal of a million and a half families each year from the retail market place. In the already "down market" we have now and likely to have for some time ahead, that many fewer customers can certainly be significant. Most important currently, it would be a continuing restraint on ongoing efforts to restore and maintain vitality to our nation's economy.

When this Bill was initially proposed we had a buoyant economy. Today the President is trying to invigorate a weak economy. Is this Bill contrary to the President's efforts? I think it is.

I respectfully suggest to you that in view of our economic climate today, the Bill should be studied and reported on to you by economists as to it's effect on our economy before the Bill goes further in Congress.

In the time these amendments to the Bankruptcy Code have been pending in Congress not only has the economy changed, the number, size, and complexity of business bankruptcy cases have materially increased. Our Bankruptcy Courts are burdened as never before and bankruptcy cases are more costly than ever before, yet the Bill does nothing to present effective ways to speed and make less costly the bankruptcy process.

Indeed, in spite of the need to reduce costs, this Bill would increase fees and costs, particularly for the individual, non-business debtor. It will also substantially add to the expense borne by the Government because of the added work and duties of the Bankruptcy Judges, the U.S.Trustees and the Estate Administrators in overseeing and monitoring the various features of the Bill, such as credit counseling agency approvals, the new means test, and as a result of the many more chapter 13 cases to be in the system.

One of the positive changes to bankruptcy practice and procedure in the pending Bill is the requirement that an individual debtor, before filing his or her bankruptcy petition must seek credit counseling. The credit counseling is to be by an agency approved by the United States Trustee or the Estate Administrator.

The Bill does provide the U.S.Trustee or Administrator with a number of general standards to guide the approval. But it does not give them any specific authority to develop and issue any guidelines or rules for the credit counseling agencies to follow that would aid or instruct the credit counseling agencies on matters relating to obtaining and maintaining compliance with those statutory standards.

The U.S. Trustee has had, for a number of years, statutory authority to formulate and issue procedural guidelines for reviewing applications of professionals employed in bankruptcy cases for compensation and for reimbursement of expenses incurred in their work. Those guidelines adopted by the U.S.Trustee work well as supplements to the statutory provisions for awarding payments. The guidelines have been a substantial aid in regularizing the presentation of applications. They help importantly to develop consistency and transparency for the disclosure of information relevant to the consideration of the factors needed to determine a proper fee and expense amount.

A similar authority to establish guidelines supplementing the statutory standards should be in this new procedure for credit counselors.

Without the ability to fix procedural guidelines to aid the approval process, neither the U.S. Trustee nor the Estate Administrator have enough tools for them to fully do their job. While some rule making power might be inferred by the duty to determine approvals, that plain language is lacking in the Bill. It leaves the government's approvers unable to assuredly establish appropriate procedural guides for themselves and for the credit counseling agencies who want to be on the approved list.

I respectfully suggest you add to the pending Bill sufficient authority for the U.S. Trustee and the Administrator to issue enforceable instructional guidelines to facilitate the credit counseling approval process.

This hearing has been called to consider "The Need for Bankruptcy Reform Legislation".

Do we need some bankruptcy reforms? The answer is "Yes we do.".

We need bankruptcy reform legislation, but this Bill doesn't provide reforms where we need them or as we now need them.

I submit that this Bill is inadequate and untimely. It should be restudied and sent back to the scriveners.

Thank you for the opportunity to make this submission to the Committee.

Credit Union Journal

February 24, 2003

SECTION: Vol. 7; No. 8; Pg. 23

LENGTH: 1316 words

HEADLINE: Only Thing Bankrupt Is Logic Behind 'Reform'

BYLINE: By Jim Blaine

BODY:

The holiday season is a wonderful way to end the year! A time of faith, family, fellowship and-lest we forget- feasting! Food, food, and more food! Provocatively tempting aromas and tantalizing tastes, all-ah-h-h-h!- well worth the weight! And, the main focus of the feasting, the sine qua non is usually A FAMOUSLY FAT TURKEY; which, of course, brings to mind the oft-pedaled, but yet to be passed BANKRUPTCY ABUSE REFORM ACT (C'mon, quit acting so shocked; you knew darn well this was coming sooner or later! Get over it! Here it is!)

About the Bankruptcy Abuse Reform Act, Oscar Wilde said it best: "It is often with the best intentions that some of the worst work is done." Pretty perceptive of Wilde in that he-like most of the rest of us-never read, let alone studied, this 400-page magnum ugly opus. Yet even a cursory review of the act quickly reveals that -just like that holiday turkey-this particular "bird" has been fully "stuffed" by way too many cooks-all seeking to suit their own particular tastes.

All of us do feel betrayed when a member defaults on a loan. After all, the credit union is a cooperative and the member did "promise to pay." Plus, most of us can relate a tale or two of "woe and abuse" featuring "shifty" members, "opportunistic" lawyers and "bleeding heart" judges. The only problem with these yarns is that much like political campaign promises and stories of male, pre-teen sexual conquests, they usually don't hold up real well to serious scrutiny!

Real Live Facts

For example, take a look at the two charts with data from www.ncua.gov. Here are a few "facts" that are actually true!! First, credit union lending remains very strong-up 7% to $322 billion at Dec. 31, 2001. Loan delinquency is well controlled at .85% (less than 1%!) and is down by 15% over 1997. The allowance for loan loss (ALL) is actually lower at .87% than at the end of 2000!

Collectively we added .32% to the loan loss reserve in 2001, a bit less than in 2000. Since credit unions are required by federal statute and GAAP to accurately assess and accrue our potential loan losses through the ALL, the future apparently looks very bright to the CEOs who faithfully attest to credit union financial statements. (We are reporting "good numbers"-aren't we?)

Charge-offs, too, are well under control at .46% of total loans (less than ?%). In other words, 99.5% of credit union loans are repaid as promised. According to NCUA 41.1% of credit union charge-offs are related to bankruptcy. Or said another way, just .19% (less than 2/10th of 1%!) of total credit union loans result in a bankruptcy loss. Not exactly a shock wave of loss and abuse, is it? Is it?

But, hold on, there's more. In 1999, the Government Accounting Office (GAO) thoroughly analyzed the issue of personal bankruptcy. The GAO is the federal government's impartial watchdog. The GAO particularly looked at three financial industry studies of bankruptcy loss and abuse. Ernst and Young conducted two of the studies sponsored by Visa and Mastercard! Creighton University also sponsored a study, as did the Executive Office for U.S. Trustees (EOUST). Some interesting results.

Even Studies That Are Creditor Friendly...

These reports looked at bankruptcy filers who could pay something if bankruptcy had a "means test" (as the current bill promotes). The assumptions were very creditor friendly, assuming, for example, that filers' incomes and financial circumstances would not change during bankruptcy. Even so, the following were the results of the studies indicating "under best-case scenarios" who could pay. The "can pays" are those described as "abusers" in the current debate hype. (Those who would be forced into a Chapter 13 plan.)

So, based on industry-sponsored studies, the maximum "abusive level" of bankruptcy is between 3.6% and 15%. (Remember, these are industry-sponsored studies!!)

So, let's calculate what abuse means. First, remember we calculated above that total bankruptcy losses were .19% of credit union loans losses. (Total charge-offs .46% x 41.1% related to bankruptcy = .19%). Therefore, the range of loan losses related to "abusive bankruptcy" would be calculated as follows (based on the GAO studies):

Estimated level of abuse: 15% in the 1998 Ernst & Young study; 10% in the 1999 Ernst & Young and Executive Office of U.S. Trusttes study, and 3.6% in Creighton University's 1999 study

Maximum Range of Losses from "Abuse":

* .19% x 15% = .0285% (less than 3/100ths of 1%!) highest estimate

* .19% x 10% = .019% (less than 2/100ths of 1%!) mid-range estimate

* .19% x 3.6% = .0068% (less than 1/100th of 1%!!!) lowest estimate

Perhaps a clearer translation of these statistics is if credit unions want "to overcome bankruptcy abuse" all they need to do is raise loan rates by one to three one-hundredths of 1%. Worst-case cost of "bankruptcy abuse" on credit union lending rates is three basis points! (Some of you spend more on board planning sessions!)

Credit unions have many issues far more important than "one to three basis points." One of those problems could be the following three paragraphs from a September 2002 letter from Ralph Nader to CUNA CEO Dan Mica:

"It is extremely disappointing to see the Credit Union National Association link hands with the long-time enemies of the credit union movement in support of legislation which would destroy consumer bankruptcy protections and turn the nation's bankruptcy courts into a destructive punitive debt collection enterprise.

The good name of credit unions should not be attached to such an anti-consumer scheme. It is no secret to you that the credit union support is providing cover for financial institutions that have engaged in sleazy, unfair, deceptive and, yes, predatory lending practices which have forced many families into foreclosures and bankruptcy.

Using these same well-honed tactics of deception, the banks and credit card companies allied with car dealers, finance companies and other credit merchants have conducted a campaign of the "big lie" to suggest that people who fall into bankruptcy are "dead beat big spenders" intent on abusing and misusing the bankruptcy laws. The Congress, awash in campaign contributions from the financial industry, is all too willing to accept these false claims."

You certainly don't have to be a fan of Ralph Nader (personally I still think the convertible Corvair is one of the sexiest cars ever made - even Ralph Nader thought it was "hot, hot, hot!") to ask: If we are "carrying water" for "our enemies" and being rebuked by "our friends"-isn't something wrong with this picture? Shouldn't "pro-credit union" and "pro-consumer" go hand in hand? How can the bankruptcy bill be anti-consumer and pro-credit union?

One credit union national trade association recently said about 2003: "We're looking for a serious opportunity to pass the bill into law." It is time to get serious about bankruptcy reform. But, we need something a bit more serious than "opinion poll leadership" from our trade associations. The current bill's a real turkey-promise! Given the continuing controversy shouldn't we at least get together and talk it over?

If not, if careful reconsideration is too great a danger, if pointing out that this "bird is a turkey" is too embarrassing at this late date; if political posturing is all the "substance" we have, then perhaps our leadership should also-while they're at it-lobby for new legislation mandating a cure for cancer.

They'd get far better press and equally meaningful results! And, hey, we'd all support you on that one!

Jim Blaine is CEO of State Employees Credit Union. Mr. Blaine can be reached at P.O. Box 27665, Raleigh, NC 27611.

LOAD-DATE: February 24, 2003

Lexington Herald Leader (Kentucky)

December 8, 2001 Saturday FINAL EDITION

SECTION: BUSINESS; Pg. B1

LENGTH: 635 words

HEADLINE: BANKRUPTCY;
REFORM BILL DRAWS OPPOSITION BIG CREDITORS' ATTORNEY SEES BIG PROBLEMS

BYLINE: Jim Jordan, Herald-Leader Business Writer

BODY:

Judges and debtors' attorneys have been fighting bankruptcy reform almost from the day Congress began considering the current bill in 1997.

Now a prominent attorney for large creditors -- the main supporters of the bill -- is also saying the Bankruptcy Reform Act is a bad idea.

It would disrupt the system and drive up the cost of bankruptcy for debtors and creditors, said Richardo I. Kilpatrick, president of the American Bankruptcy Institute.

"It goes too far," Kilpatrick said. "If this is enacted, it will last 18 months to two years. The (bankruptcy) court is going to come to a halt. It's going to slow the process substantially."

Kilpatrick spoke yesterday during the 10th Biennial Judge Joe Lee Bankruptcy Institute at the University of Kentucky College of Law.

Lee, who retired in 1997 as chief judge of the U.S. Bankruptcy Court in Lexington but continues to hear cases, also opposes the bill, in part because it would limit the authority of judges.

"As you can see, you have a problem and we judges will have a problem," Lee told an audience of judges and lawyers after Kilpatrick spoke. "We (judges) will have less discretion than an IRS agent."

Kilpatrick said opponents of the bill, which was known as the Bankruptcy Reform Act of 2000 until it was vetoed a year ago by President Clinton, might have as long as 18 months to derail the most harmful parts of the proposal

The centerpiece is a "means test" that would force debtors to repay part of their debts if their income is above a certain level after exemptions are allowed.

Instead of getting a fresh start, debtors could be placed in financial servitude for up to six years, Kilpatrick said. Some will fall into "a no-person's land" where they won't be able to file for bankruptcy until their finances worsen enough to meet the test.

Among other problems, Kilpatrick said, the act contains vague wording that will lead to lawsuits and it also has loopholes that will allow wealthy debtors with savvy lawyers to escape many of its harsher provisions.

The bankruptcy act of 1978 sparked six years of court battles to clarify the law and the current proposal will be no different. "We are going to litigate. We are going to have to decide what these provisions mean," he said.

The act also would require lawyers to investigate their clients' finances and guarantee the accuracy of information provided by clients. The added liability will lead to delays and, he predicted, the doubling of legal fees.

"It's not a better mousetrap," Kilpatrick said. "It's a series of pitfalls for the unwary."

The Michigan lawyer said Congress won't consider the measure this year or next year because of the war on terrorism and other pressing issues.

Meanwhile, he predicted, some non-controversial parts of the act will become law in 2002 by being attached to other bills. They include creating 24 judgeships and requiring debtors to take money-management classes.

But pressure will begin mounting as early as 2003, when the skyrocketing number of bankruptcy filings in the United States could top 2 million a year for the first time ever.

Creditors will again begin calling for a crackdown on debtors who are abusing the system, he said. That might lead to passage of a means test and other controversial parts of the Bankruptcy Reform Act of 2000 if lawyers and judges haven't been able to convince Congress it's a bad idea.

"We all know it's a very small minority of people who abuse the system," Kilpatrick said. Most debtors are in bankruptcy because of job loss, illness or divorce, and the current recession can only make the situation worse.

"People are in trouble," he said. "We are in a recession. That's really the bottom line."

*

Reach Jim Jordan at (859) 231-3242 or jjordan1@herald-leader.com.

LOAD-DATE: December 11, 2001

Mr. WATT. I ask unanimous consent that a letter dated March 4, 2003 from the American Bar Association be made a part of the record. It is addressed to you as Chairman of the Subcommittee.

Mr. CANNON. Without objection, so ordered.

[The material referred to follows:]

Defending Liberty
Pursuing Justice

AMERICAN BAR ASSOCIATION

Governmental Affairs Office
740 Fifteenth Street, NW
Washington, DC 20005-1022
(202) 662-1760
FAX: (202) 662-1762

March 4, 2003

The Honorable Chris Cannon
Chairman
Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

Re: Subcommittee Hearing on H.R. 975, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2003," Scheduled for March 4, 2003

Dear Mr. Chairman:

As you and your colleagues begin your consideration of H.R. 975, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2003," the American Bar Association ("ABA") respectfully urges your subcommittee to delete several provisions from the legislation that unfairly increase the liability and administrative burdens of bankruptcy attorneys under the Bankruptcy Code. In particular, the ABA urges your subcommittee to delete those provisions that would require attorneys to: (1) certify the accuracy of factual allegations in the debtor's bankruptcy petition and schedules, under penalty of court sanctions; (2) certify the ability of the debtor to make payments under a reaffirmation agreement; and (3) identify and advertise themselves as "debt relief agencies" subject to a host of new intrusive regulations. Attached for your review and consideration are specific amendments supported by the ABA that would eliminate these new attorney liability provisions. It is our understanding that these and other bankruptcy issues will be discussed during your subcommittee's hearing this afternoon, and we ask that this letter be included in the hearing record.

The ABA, with over 400,000 members throughout the country, strongly opposes the new attorney liability provisions contained in H.R. 975 that apply only to debtors' counsel. In our view, these provisions will have a strong negative impact on individual debtors who are seeking a fresh start under the bankruptcy laws by subjecting their attorneys to costly new regulations and liability beyond those faced by lawyers in any other field of practice. These three provisions, discussed in greater detail below, would discourage many attorneys from agreeing to represent debtors at all, while significantly increasing the fees and expenses of clients who are able to obtain legal representation. In addition, these new provisions will discourage lawyers from volunteering their services for *pro bono* bankruptcy cases. Unless they are removed, these provisions pose a serious threat to the efficient operation of the bankruptcy system.

Certification of Bankruptcy Petitions and Schedules

The American Bar Association strongly opposes the provisions in H.R. 975 that would require the debtor's attorney to certify the accuracy of all factual allegations in the debtor's bankruptcy petitions and schedules and would subject the attorney to harsh court sanctions if any factual inaccuracies resulted in the dismissal of the debtor's Chapter 7 bankruptcy petition or in its conversion to a Chapter 13. During last year's House-Senate conference committee negotiations, the provision requiring the court to impose sanctions against attorneys for inaccurate bankruptcy schedules was replaced with a discretionary standard. Although that change was a significant improvement, the current language will still have severe negative effects on the bankruptcy court system.

Under current Bankruptcy Rule 9011, bankruptcy attorneys, like all other attorneys appearing in federal courts, are required to certify that pleadings and other items that they prepare are supported by the facts before they are filed with the court. This rule, which is identical in form and substance to Federal Rule of Civil Procedure 11, applies to all pleadings and motions filed with the bankruptcy court. By its own terms, however, Rule 9011 does not apply to the bankruptcy schedules listing the debtor's financial information. Because those schedules are prepared almost entirely with information supplied directly by the debtor, Rule 9011 allows bankruptcy attorneys to rely upon the accuracy of that information. Therefore, the debtor alone has been held responsible for the truthfulness and accuracy of the bankruptcy schedules.

Section 102 of H.R. 975 would change existing law by creating a new and higher standard for debtor bankruptcy attorneys that goes well beyond the standards imposed upon other attorneys. By creating new subsections 4(A) – (D) to 11 U.S.C. § 707(b), Section 102 of the bill would hold the debtor's attorney—instead of the debtor—financially responsible for any factual errors contained in the debtor's bankruptcy petition or schedules. Therefore, if even innocent errors in the petition or the schedules result in the dismissal of the petition or in its conversion to a Chapter 13 proceeding, the debtor's attorney could be held financially responsible unless it is proven that the attorney conducted a time-consuming and costly investigation of these factual allegations before the filing.

In addition, while current Rule 9011 holds all bankruptcy attorneys to the same standards, Section 102 of H.R. 975 unfairly discriminates between debtor and creditor attorneys. Section 102 provides that if the debtor's petition or schedules are found to violate Rule 9011 and the debtor is denied a discharge under the means test outlined in H.R. 975, the debtor's attorney would be subject to court sanctions and could be held personally liable for the attorneys' fees of the trustee or bankruptcy administrator who contested the discharge. In contrast, attorneys representing creditors would not be required to make any additional certifications and would not be made subject to new sanctions under the legislation.

The new standards outlined in Section 102 of H.R. 975 also would fundamentally alter the attorney-client relationship in bankruptcy cases. It would transform the attorney from an advocate to a detective and informer. The legislation would create an unwaivable conflict of interest because the attorney would be unable to accept information provided by the client at face value without risking liability if the information later proved to be inaccurate. Further, the debtor's attorney would be required to independently verify all of the client's factual representations. Indeed, the attorney would be forced to appraise the value of all of the assets listed on the client's schedules.

Requiring the debtor's attorney to verify all of the client's representations would significantly raise the cost to the debtor of filing for bankruptcy. As a result of the new obligations and liability imposed on attorneys by Section 102, many bankruptcy counsel will no longer agree to accept debtors' cases because these attorneys will not be willing to become their client's insurer. In addition, those bankruptcy lawyers who continue to represent debtors will be forced to charge substantially higher fees (which most debtors will be unable to afford). Therefore, the practical effect of these provisions will be to deny debtors timely, effective, and affordable representation just when they need it most.

In addition, even when a debtor is fortunate enough to find an attorney who is willing to handle the bankruptcy case, the new potential liability created by Section 102 will have a severe chilling effect on the attorney's willingness to advocate a new position or theory on behalf of the client. Because the debtor's attorney could face substantial monetary sanctions if the attorney's efforts to maintain a Chapter 7 case are unsuccessful and the court finds that Rule 9011 was violated, the debtor's attorney will be reluctant to advance any but the most well-established legal theories and arguments. As a result, debtors will no longer receive the kind of vigorous representation to which they are entitled under the law and which attorneys have always been required to provide. For all of these reasons, the ABA believes that new subsections 4(A) – (D) contained in Section 102 are counterproductive and should be removed from the bill.

Certification of Reaffirmation Agreements

The ABA also urges your subcommittee to delete the provisions from Section 203(a) that would require attorneys to certify the debtor's ability to make payments under a reaffirmation agreement.

Under current law, a debtor is not required to accept the discharge of all outstanding debt. Instead, the debtor may choose to reaffirm certain debts—thus retaining liability for these debts—provided that the decision is voluntary and will not create undue hardship for the debtor. Before such reaffirmation agreements can proceed under current law, however, the debtor's attorney must certify that the reaffirmation is voluntary and will not impose an undue hardship on the debtor or the debtor's dependents.

Section 203(a) of H.R. 975 would change these procedures by again imposing new burdens on the debtor's attorney. Unlike the current law, which simply requires the debtor's attorney to certify in writing that the reaffirmation agreement is voluntary and would not cause the debtor undue hardship, the new provisions require the attorney to certify that "the debtor is able to make the [reaffirmation] payment," in cases where there is a presumption of undue hardship under the debtor's budget (i.e., if the debtor's monthly income is less than monthly expenses, including the reaffirmation payments).

Bankruptcy attorneys do not conduct extensive audits of their clients' finances, nor do they make financial or household budgeting decisions for their clients. Indeed, this is not the attorney's proper role, and any attempt to force the attorney to assume these duties will substantially increase the cost of representing a debtor in bankruptcy. Therefore, this certification requirement, like the certification requirement in Section 102, will discourage many attorneys from representing debtors, while forcing the remaining debtors' attorneys to charge higher fees to cover the substantial additional costs and risk.

The new certification requirement contained in Section 203(a) of H.R. 975 also will create strong conflicts of interest between the debtor and the attorney in those instances when the debtor wants to reaffirm a debt and instructs the attorney to certify the debtor's ability to make payments. If the attorney follows the client's directive, the attorney may become subject to sanctions under Rule 9011 if the debtor later proves unable to pay the reaffirmed debt. This new mandate is particularly unfair because creditor's attorneys are not subject to sanctions under Rule 9011 for their clients' false disclosures or illegal collection practices if they can show they acted in good faith and did not participate in, or have knowledge of, these disclosures or practices. For all of these reasons, the ABA believes that the provisions in Section 203(a) requiring debtors' attorneys to certify their clients' ability to make reaffirmation payments are inappropriate and should be deleted from the bill.

"Debt Relief Agency" Provisions

The American Bar Association also strongly opposes those provisions in Sections 227-229 of H.R. 975 that would require bankruptcy attorneys to identify and advertise themselves as "debt relief agencies" and then comply with a host of new burdensome regulations. These provisions would confuse the public, seriously interfere with the attorney-client relationship, and impose unfair additional burdens and liability on debtors' attorneys that constitute an unjustified government invasion of the relationship between private attorneys and their clients.

Under these provisions, any "person"—including both bankruptcy attorneys and non-attorney "bankruptcy petition preparers"—who assists individual debtors with their bankruptcies in return for compensation is deemed to be a "debt relief agency." Unfortunately, the provisions fail to take into account any of the important differences between attorneys and non-attorneys providing bankruptcy services. Under current law, only attorneys are permitted to give legal advice, file pleadings, or represent debtors in bankruptcy hearings. In addition, unlike non-attorney bankruptcy petition preparers, only attorneys are licensed by the state in which they practice, bound by canons of ethics, and subject to discipline by the courts in which they practice. More importantly, only those communications between the debtor and his or her attorney are protected by the attorney-client privilege. Requiring both attorneys and non-attorney bankruptcy petition preparers to advertise themselves as "debt relief agencies" would obscure these important distinctions while creating substantial confusion among the public.

The "debt relief agency" provisions in the bill would also interfere with the attorney-client relationship in a variety of ways. Because the definition is worded so broadly, it may be construed to apply not just to bankruptcy attorneys, but also to family attorneys, criminal and civil defense attorneys, and general practitioners who, in the course of representing their clients, are compelled to advise them to consider filing bankruptcy to protect their rights. This will significantly jeopardize the attorney's ability to properly advise his or her client regarding their legal rights.

Any attorney who assists a client with bankruptcy will be subject to a long list of new regulations under the bill. In particular, attorneys will be required to provide lengthy written disclosure statements to potential and existing bankruptcy clients that explain the bankruptcy system and that provide general, government-approved legal advice. In addition, attorneys will also be required to advise the debtor in writing that the debtor need not be represented by a lawyer in the bankruptcy or in related litigation, which in many cases is bad advice.

By requiring that the debtor's attorney provide the debtor with preprinted, government-approved legal advice on bankruptcy law, and by forcing the attorney to state in writing that the debtor need not even retain a lawyer, the bill would usurp the attorney's role as the proper legal representative of the debtor. Perhaps even more troubling, the bill would also prohibit the attorney from giving certain proper pre-bankruptcy planning advice to the client, including advice to pay certain lawful obligations or to incur certain debts. In fact, these provisions of the bill are worded so broadly that the attorney could be subject to liability merely for making an unsuccessful attempt to help the client restructure the debt to avoid bankruptcy. These provisions, which dictate the types and content of legal advice that an attorney can and cannot render to his client, are particularly destructive of the attorney-client relationship.

Sections 227-229 also require attorneys to provide the debtor with a written contract, and if the contract fails to comply with each of the detailed requirements outlined in the bill, it would be void and unenforceable. Furthermore, if the debtor's attorney failed to follow any of the many technical requirements of the legislation, the attorney would forfeit the entire fee and could be sued in state or federal court by the debtor, the trustee, or state law enforcement officials for actual damages, civil penalties, attorneys' fees, and costs. Although existing law and ethical rules require all attorneys to provide quality legal representation to their clients, Sections 227-229 go well beyond existing law and would subject just one type of attorney, debtors' bankruptcy attorneys, to a far stricter standard than attorneys in any other field of practice.

In addition, Section 229 of H.R. 975 also seeks to micromanage the bankruptcy attorney's advertising by requiring the attorney to include a conspicuous—and awkward—statement in all its advertising stating that "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." No such requirements will apply to creditors' attorneys under the bill. In addition, requiring attorneys to label themselves as "debt relief agencies" will discourage general practitioners and bankruptcy professionals who have a consumer and business, debtor and creditor practice, from advertising the availability of bankruptcy services, thus limiting consumer bankruptcy representation to attorneys with narrower practices. For all of these reasons, the ABA believes that attorneys should be exempted from the coverage of the "debt relief agency" provisions contained in Sections 227-229.

The three general types of enhanced attorney liability provisions outlined above, when taken together, will have a substantial negative impact on the availability of quality legal counsel in bankruptcy. As a result of these burdensome and one-sided mandates on debtors' attorneys, many attorneys who currently represent both debtors and creditors will stop handling debtor cases altogether rather than comply with these new regulations. With fewer attorneys available to represent debtors, many more debtors will be forced to file their bankruptcies *pro se*, without first obtaining adequate advice regarding the necessity or advisability of filing for bankruptcy. Therefore, the enhanced attorney liability provisions ultimately will have an adverse effect on debtors, creditors, and the bankruptcy system as a whole. To avoid these problems, the ABA urges you to support the proposed amendments to H.R. 975 that are attached to this letter.

Thank you for your consideration, and if you would like to discuss the ABA's views on these important bankruptcy issues in greater detail, please feel free to contact Larson Frisby, our legislative counsel for bankruptcy issues, at (202) 662-1098.

Sincerely,

Robert D. Evans

Robert D. Evans

Encl.

Cc: All members of the House Judiciary Committee

PROPOSED ABA AMENDMENTS TO H.R. 975
(as introduced in the House on February 27, 2003)

Amendment regarding certification of bankruptcy petitions and schedules:

On page 13, lines 19-25, page 14, lines 1-24, and page 15, lines 1-11, strike subsections (4)(A)-(D).

On page 15, line 12, strike "(5)(A)" and insert "(4)(A)".

On page 15, line 13, strike "(6)" and insert "(5)".

On page 16, lines 1-3, strike "the attorney (if any) who filed the motion did not comply with the requirements of clauses (i) and (ii) of paragraph (4)(C), and"

On page 17, line 1, strike "(6)" and insert "(5)".

On page 17, line 19, strike "(7)" and insert "(6)".

On page 181, lines 1-16, strike Sec. 319 and renumber all subsequent Sections in Title III accordingly.

Amendment regarding certification of reaffirmation agreements:

On page 59, line 5, strike "5(A)" and insert "5".

On page 59, lines 16-19, strike "(B) In the case of reaffirmations in which a presumption of undue hardship has been established, the certification shall state that in the opinion of the attorney, the debtor is able to make the payment."

On page 59, lines 20-21, strike "(C) In the case of a reaffirmation agreement under subsection (m)(2), subparagraph (B) is not applicable."

Amendment regarding "debt relief agency" regulations:

On page 111, after line 13, insert ",other than an attorney or an employee of an attorney,"

On page 119, lines 6 and 7, strike "AN ATTORNEY OR" and insert "A"

On page 119, line 13, strike "AN ATTORNEY OR" and insert "A"

On page 119, lines 15 and 16, strike "ATTORNEY OR"

Mr. CANNON. And I ask unanimous consent that we submit for the record, in addition to the testimony that we will receive today from the witnesses, written statements from the following organizations: The Bond Market Association, the International Council of Shopping Centers, National Association of Credit Management, National Association of Federal Credit Unions, National Multi-Housing Council and National Retail Foundation. In addition, I would like to submit for the record a statement by Philip Strauss of the San Francisco Department of Child Support Services. Without objection, so ordered.

[The material referred to follows:]

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THE BOND MARKET ASSOCIATION

Statement of The Bond Market Association

Before the
United States House of Representatives
Committee on the Judiciary Subcommittee for Commercial and Administrative Law

Hearing on Proposed Changes to Bankruptcy Laws
March 4, 2003
Submitted for the Record

The Bond Market Association appreciates the opportunity to comment on proposed reforms to the bankruptcy laws. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2003 (H.R. 975) includes several provisions that would help insulate the financial system from systemic risk—the risk that the failure of one market participant could ripple through the capital markets and bring down other participants. The Bond Market Association represents securities firms and banks that underwrite, trade, and sell debt securities both domestically and internationally. The Association's membership collectively accounts over 95 percent of the nation's bond underwriting activity.

We commend Subcommittee Chairman Chris Cannon for calling this hearing. We also commend Chairman Sensenbrenner's longstanding commitment to comprehensive bankruptcy reform. Bankruptcy reform is long overdue and we urge quick enactment of H.R. 975.

In this statement, the Bond Market Association focuses on provisions in H.R. 975 concerning the netting, close-out rights and payment risk reduction reforms of the Bankruptcy Code and bank insolvency law.

I. Introduction

Financial institutions often utilize several different but related financial transactions to obtain and provide liquidity to the marketplace, while mitigating risk. For example, a financial institution may enter into a transaction which may entail exposure, but enter into an offsetting transaction which hedges such exposure. In these important market activities, which can involve huge sums and concentrated exposures, the inability of one party to exercise its contractual "self-help" rights in the event of the insolvency of the other party could cause ripple effects, given the interconnected nature of the financial markets, undermining the financial condition of the non-bankrupt party (and its counterparties) and the markets more generally.

Recognizing the important role of these transactions in capital formation and market liquidity and the potential for a chain reaction of insolvencies should non-bankrupt parties' contractual self-help rights be impaired, Congress has included provisions in the Bankruptcy Code and the bank insolvency laws that expressly protect the exercise of such rights in the event of bankruptcy or insolvency. However, it has been more than ten years since the last legislative update to the safe-harbor provisions. The financial markets have evolved during that time in ways that leave various transactions and parties subject to legal uncertainty. As more types of market participants have engaged in a broader range of transactions, statutory inconsistencies have surfaced that make it difficult to conclude that Congress's goal of minimizing systemic risk has been fully achieved through the existing market safe harbors. Important technical corrections are needed to minimize systemic risk in light of market developments.

The comprehensive bankruptcy bill would substantially improve the statutory regime that governs financial transactions when a party fails to meet its payment obligations. This legislation would harmonize the Bankruptcy Code and bank insolvency laws governing swaps, repurchase agreements, securities contacts, forward contracts, and commodity contracts. The Bond Market Association urges Congress to enact the full set of bankruptcy and insolvency law changes that are needed to protect modern financial markets. These proposed changes are entirely consistent with many statutory provisions that have already been enacted, and are in the nature of technical corrections.

II. The Current Safe Harbors Need to be Updated

A. Swap Agreements

Swap agreements are privately negotiated contracts between parties to exchange payments under specified conditions. The parties' obligations are linked to some index, commodity price, interest rate, currency or other indication of economic value. In an interest rate swap, for example, two parties agree to exchange payments based on some agreed upon notional principal amount. However, principal does not typically change hands in a swap contract. It merely serves as the reference for the calculation of the payments to be made.

The primary purpose of swaps is risk management. The universe of parties actively engaged in swaps is expansive and growing: banks, securities firms, mutual funds, pension funds both public and private, manufacturing firms, and state and local governments, just to name a few. Virtually all significant commercial enterprises face certain risks that can be managed through the use of swaps. In the example that follows, Party B attempts to manage its exposure to changes in interest rates through the use of an interest rate swap:

> **Example 1.** Two parties to an interest rate swap agree to exchange payments based on a $1 million notional amount. Party A agrees to pay a fixed rate of seven

3

> percent, and Party B agrees to make floating payments based on some market index. If payments are exchanged once per year, Party A would pay Party B $70,000 (seven percent of $1 million) and Party B would pay Party A $40,000 in the first year (four percent of $1 million), assuming that the floating rate index were four percent at the time of calculation. In practice, the payments are netted so that Party A simply pays Party B $30,000, or $70,000 - $40,000. (In this example, Party B may have floating rate assets and fixed rate liabilities, and it desires to hedge that mismatch. In this example, the payment that Party B receives makes up for the reduced return Party B receives on its floating rate assets, allowing it to satisfy its fixed rate liabilities. Party A may be a dealer, who hedges its position by taking an offsetting position, either in the swaps market or in another fixed income market.)

The fundamental contractual terms in a swap for the exercise of remedies in the event of bankruptcy or insolvency provide for "close-out," "netting" and foreclosure. Close-out involves the termination of obligations between the parties and the calculation of gain or loss. Netting involves offsetting the parties' gains and losses to arrive at a net outstanding amount payable by one party to the other. Foreclosure involves the use of pledged assets to satisfy the net payment obligation. The ability to execute this process swiftly is key to the financial markets and the solvency of its participants due to the potential exposure a counterparty in such transactions has to market risks and the possibility of changes in the values of financial contracts and collateral due to market movements. The inability of a financial market participant to exercise these remedies promptly could impair its liquidity and solvency.

The following is a basic example of the close-out, netting and foreclosure process:

> **Example 2.** Party A and Party B enter into two interest rate swaps at different times (Swap X and Swap Y). Both contracts contain provisions that allow for close-out, netting and foreclosure and are in effect when Party A becomes insolvent. At the time of Party A's insolvency, Party A's mark-to-market loss under the terms of Swap X is $30 million and its mark-to-market gain under the terms of Swap Y is $20 million. Through the process of close-out and netting, the swaps are terminated and Party A owes Party B $10 million. If Party A had pledged $15 million of collateral to Party B, Party B would foreclose on the collateral, use $10 million to satisfy Party A's obligation, and return $5 million to Party A.

If Party A became subject to a proceeding under the Bankruptcy Code, Party B would be entitled under current law (Sections 362(b)(17) and 560 of the Bankruptcy Code) to exercise its self-help close-out, netting and foreclosure remedies as described above. If Party A were an FDIC-insured bank that became subject to a receivership (and Swaps X and Y were not transferred to a successor entity), Party B would be entitled under the Federal Deposit Insurance Act to exercise its self-help close-out, netting and foreclosure remedies as described above. In either case, if Party B were unable to exercise such remedies, its liquidity and solvency could be impaired, creating gridlock and posing the risk of systemic problems.

The swaps market has evolved since the protections for interest rate and other swaps were first put in place. Parties have learned to apply the principles of risk management in many different ways that are not expressly covered under the applicable definitions in the Bankruptcy Code and the Federal Deposit Insurance Act. As a result, the markets in some cases proceed under some degree of legal uncertainty regarding the enforceability of certain contracts, even though they are economically equivalent to other contracts that are expressly protected and pose the same risks that Congress has sought in the past to avoid.

For example, if in the above hypothetical the two swaps were equity swaps in which the payments were calculated on the basis of an equity securities index, it is not entirely clear that the transactions would fall within the market safe harbor in the Bankruptcy Code or the Federal Deposit Insurance Act for "swap agreements." If both of the parties were "financial institutions" under the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve Board's Regulation EE and the swap agreement were a "netting contract," then Party B might (although it is not entirely clear) be able to exercise close-out, netting and foreclosure rights in respect to the equity swap transactions. If one of the parties were not a "financial institution" or the contract did not constitute a "netting contract" (for example, because it was governed by the laws of the United Kingdom), then Party B could be subject, among other things, to the risk of "cherry-picking"--the risk that Party A's trustee or receiver would assume Swap Y and reject Swap X, leaving Party B with a $30 million claim (which would be undersecured because of the impairment of netting) and to the risk that its foreclosure on the collateral would be stayed indefinitely. This could impair Party B's creditworthiness, which in turn could lead to its default to its counterparties. The pending legislation would minimize these risks by making clear that an equity swap is a "swap agreement," entitled to the same market safe harbors as interest swap agreements.

B. Repurchase Agreements

Repurchase agreements, also known as "repos," are contracts involving the sale and repurchase of securities or other financial assets at predetermined prices and times. Although structured and treated for legal purposes as purchases and sales, economically repos resemble secured lending transactions. In economic terms, one participant in the repo transaction (the "seller") is borrowing cash at the same time that the other participant (the "buyer") is receiving securities. The recipient of cash agrees to re-pay the cash (e.g. to repurchase the securities)-- at a predetermined time and price, including a price differential (the economic equivalent of interest). The buyer agrees to purchase and later resell the securities to the seller.

According to published reports, on average in 2002, nearly $3.8 trillion in repos were outstanding between dealers of U.S. government and federal agency securities, up from an average of $3.1 trillion in 2001. Parties also routinely engage in repo

transactions involving non-agency mortgage-backed securities, whole loans and other financial instruments. Participants in the repo market are diverse, including commercial banks, securities firms, thrifts, finance companies, non-financial corporations, state and local governments, mutual and money-market funds. The repo markets also play an integral role in the Federal Reserve's open market operations, which allow the Federal Reserve to meet its Fed Funds target.
In 1984, Congress acted to protect certain types of repos from the insolvency of market participants after the 1982 Lombard-Wall bankruptcy court decision cast uncertainty on the ability of market participants to close out their positions. According to the Senate Judiciary Committee report on the 1984 legislation, that decision had a distinct adverse effect on the financial markets. At that time, Congress granted protection only to repos involving certificates of deposit, eligible bankers' acceptances, and securities that are direct obligations of, or that are fully guaranteed as to principal and interest by, the federal government. In doing so, Congress expressly stated that repos serve a vital role in reducing borrowing costs in the markets for these securities and sought to encourage market participants to use repos with confidence.

Unfortunately, the list of instruments protected by those 1984 amendments to the Bankruptcy Code has grown outdated as market participants have entered into repos involving a wide range of financial assets. Besides repurchase agreements on government and federal agency securities, which are covered under the Bankruptcy Code and Federal Deposit Insurance Act definitions of "repurchase agreement," firms now actively engage in repurchase agreements on the foreign sovereign debt of OECD countries, whole mortgage loans, and mortgage-backed securities of many types. Under H.R. 975, each of these types of repurchase agreements would be covered by the market safe harbors provided in the Bankruptcy Code (they are already covered by the Federal Deposit Insurance Act and regulations thereunder). Market participants could then enter into such transactions with greater confidence that they will be easily enforceable, improving the liquidity and cost of financing in the markets for the underlying instruments, and minimizing systemic risk.

C. Securities Contracts, Forward Contracts and Commodity Contracts
Market participants enter into contractual arrangements for the sale of securities and commodities where payment and delivery obligations are fulfilled at some future date. Securities contracts, forward contracts, and commodity contracts all can take many forms, but they can also be similar from an economic perspective. "Securities contracts" include forward purchases of securities, pursuant to which the parties agree to exchange payments and securities at a fixed date in the future. "Forward contracts" include privately negotiated arrangements where one party agrees to sell a commodity to another party at a fixed price for delivery at a future date. The terms of forward contracts can closely resemble those of futures contracts (which are "commodity contracts"). However, forward contracts are not traded on commodity exchanges under standardized terms and the parties envision actual delivery of the underlying commodity.

Despite the economic similarities of securities contracts, forward contracts and commodity contracts, the Bankruptcy Code and the Federal Deposit Insurance Act are inconsistent in their treatment of these transactions. Under the Federal Deposit Insurance Act, any counterparty can close out and net obligations under all securities contracts, forward contracts or commodity contracts it may have outstanding with the FDIC-insured bank in a liquidating receivership. However, if the failing counterparty is a debtor subject to the Bankruptcy Code, the enforceability of close-out provisions depends on a number of factors, including the type of counterparty, and the type of contract involved. In order to close out and net "securities contracts," the non-bankrupt counterparty must be a "stockbroker," "financial institution" or "securities clearing agency." In order to close out and net "forward contracts," the non-defaulting party must qualify as a "forward contract merchant." A few examples illustrate these differences:

> **Example 3.** Party A, a mutual fund, and Party B, a securities dealer, have two outstanding contracts for the purchase of securities, one that is in-the-money to Party A, one that is out-of-the-money to Party A. If Party B becomes the subject of proceedings under the Bankruptcy Code, Party A would not be able to close out the contracts and net its obligations to Party B under the out-of-the-money contract against Party B's obligations under the in-the-money contract (unless it had acted through a bank agent). However, if it is Party A that becomes the subject of proceedings under the Bankruptcy Code, Party B would be able to close out the transactions and net its obligations. This is because Section 555 of the Bankruptcy Code allows liquidation of securities contracts only by stockbrokers, financial institutions and securities clearing agencies, none of which includes the mutual fund (unless it had acted through a bank agent).
>
> **Example 4.** Now assume that in the above example Party B is an FDIC-insured depository institution. If Party B becomes the subject of receivership proceedings and the securities contracts with Party A are not transferred to a successor institution, Party A will be able to close out the transactions and net the obligations thereunder. This is because the Federal Deposit Insurance Act, since 1989, contains no counterparty restrictions.
>
> **Example 5.** Party A, the mutual fund, and Party B, an affiliate of a securities dealer, have two outstanding forward foreign exchange contracts. If Party B becomes the subject of proceedings under the Bankruptcy Code, Party A would be able to close out and net the foreign exchange transactions. This is because Section 556 of the Bankruptcy Code allows liquidation of "forward contracts" (the foreign exchange transactions) by forward contract merchants, a classification that includes the mutual fund. (Note that the forward foreign exchange contracts would also be "swap agreements," and the mutual fund, as a "swap participant," could exercise its rights on that basis as well. Other "forward contracts" would not qualify as "swap agreements.")

Thus, parties of similar size who enter the markets with equal frequency and in the same manner enjoy different degrees of protection under the Bankruptcy Code and the Federal Deposit Insurance Act. This makes no sense from the point of view of the reduction of systemic risk -- the failure of these market players could trigger the same kind of chain reaction that a bank, broker-dealer or clearing agency failure could trigger. The pending legislation would improve the current situation by making certain technical definitional changes under the Bankruptcy Code (to bring it closer to the Federal Deposit Insurance Act). The amendments would expand the universe of counterparties whose contractual rights would be enforceable. In addition to stockbrokers, financial institutions, registered investment companies and securities clearing agencies, large and sophisticated market participants would be able to close out their securities contracts, forward contracts and commodity contracts against Bankruptcy Code debtors. Such counterparties would be defined as "financial participants" under the Bankruptcy Code through certain quantitative tests modeled on the Federal Reserve Board's Regulation EE. Once amended, the counterparty limitations under the Bankruptcy Code would have a more rational scope than they do under current law.

D. Cross-Product Netting

Financial market participants often have a wide range of transactions outstanding with one another at any given time. Thus, a given party's exposure to the risk of default by another party may be understood only by considering the total value of the payments that party expects to receive and pay under all of the various contracts. The Federal Deposit Insurance Act reflects an understanding of this and permits the netting of obligations stemming from one type of "qualified financial contract" against obligations stemming from another type of "qualified financial contract." This practice, known as "cross-product" netting, permits more rational risk management practices and allows market participants to resolve whatever problems arise from the insolvency of one of their counterparties in a more orderly fashion. Cross-product netting also reduces the likelihood of systemic risk, as it allows the non-bankrupt counterparty to crystallize its exposure and not be treated as a secured creditor with an interest in cash collateral subject to the automatic stay.

Cross-product netting is also permitted under the Bankruptcy Code, but to a lesser degree. Parties can net their obligations under securities contracts, forward contracts and commodity contracts against one another. It is unclear whether cross-product netting is permitted, however, when the contracts involved are swaps and repurchase agreements.

> **Example 6.** Party A, a securities dealer, and Party B, a large corporation, have an outstanding securities contract that upon close-out is profitable for Party A. The parties also have an outstanding forward contract that upon close-out is profitable for Party B. When Party B becomes the subject of a proceeding under the Bankruptcy Code, Party A would be able to close out each of the contracts and offset its obligation to pay Party B under the forward against Party B's obligation to Party A under the securities contract.

> **Example 7.** Party A and Party B have an outstanding swap that upon close-out is profitable for Party A. The parties also have an outstanding repurchase agreement under which Party A holds securities purchased from Party B that upon close-out is profitable to Party B (i.e., the value of the securities exceeds the repurchase price). If Party B becomes the subject of proceedings under the Bankruptcy Code, Party A would not clearly be able to offset the excess repo proceeds against Party B's outstanding obligation under the swap. At worst, Party A would be treated as a secured creditor with a security interest in the repo proceeds. Its rights could, however, be subject to the automatic stay, thereby impairing its liquidity and creating the potential for systemic risk.

There is no plausible rationale for treating cross-product netting between securities, forward and commodity contracts differently from cross-product netting between those contracts, swap agreements and repurchase agreements. These anomalies emerged over time, as various protective provisions were added to the Bankruptcy Code to protect various types of markets. (Because the "qualified financial contract" provisions of the Federal Deposit Insurance Act were enacted at the same time, no such anomalies exist in those provisions.) However, the capital markets have grown and matured to such an extent that various types of market participants now engage in many types of transactions, and it is time for the market safe harbors to be rationalized and made consistent in their application to all financial products for all participants.

Wider and more certain cross-product netting in cases of bankruptcy should allow parties to enter into additional types of transactions with the same counterparty without necessarily increasing, on a net basis, their overall credit exposure or risk to the markets as a whole. Indeed, some cross-product transactions will serve to reduce a counterparty's overall risk, facilitating better risk management and reducing overall risk in the financial markets.

III. Conclusion

The above examples illustrate the need for Congress to enact bankruptcy reform and the financial contract provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, which would make important, but highly technical changes to the Bankruptcy Code and the Federal Deposit Insurance Act. These changes are consistent with the existing market safe harbors in the Bankruptcy Code and the Federal Deposit Insurance Act and will encourage broader use of sound risk management techniques and help to minimize overall systemic risk. We urge Congress to act quickly on this important legislation.

Prepared Statement of the International Council of Shopping Centers

INTRODUCTION

The International Council of Shopping Centers (ICSC) is pleased to present this written statement for the record to the House Judiciary Committee's Subcommittee on Commercial and Administrative Law in conjunction with its March 4, 2003 hearing on the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2003* (H.R. 975).

ICSC is the global trade association of the shopping center industry. Its 41,000 members in the United States, Canada and more than 77 other countries around the world include shopping center owners, developers, managers, investors, lenders, retailers and other professionals. The shopping center industry contributes significantly to the U.S. economy. In 2002, shopping centers in the U.S. generated over $1.2 trillion in retail sales and over $53 billion in state sales tax revenue, and employed almost 11 million people.

First and foremost, ICSC would like to commend the House Judiciary Committee and this Subcommittee for its efforts over the past few years to enact meaningful bankruptcy reform legislation. We are hopeful that H.R. 975, recently introduced by Committee Chairman James Sensenbrenner (R-WI), will be enacted promptly so it can end existing abuses of the bankruptcy system. Although all of ICSC's concerns are not addressed in H.R. 975, we believe it is a well-balanced piece of legislation and should be approved and signed into law as soon as possible.

BUSINESS BANKRUPTCY ABUSES ARE A GROWING PROBLEM

As we all know, an increasing number of retailers and entertainment establishments have been filing for bankruptcy protection over the last few years, including Ames, Bradlees, Crown Books, FAO Schwartz, Filenes Basement, Grand Union, Kmart, Lechters, Montgomery Ward, United Artists, and Zany Brainy, just to name a few. It seems as if every week another longstanding business is declaring bankruptcy. Furthermore, until our nation's economy reaches full recovery, it is very likely that additional businesses—both large and small alike—will be forced to seek the protections of Chapter 7 and 11 of the U.S. Bankruptcy Code.

ICSC supports and respects an underlying goal of the bankruptcy system that companies facing financial catastrophe should be able to reorganize their businesses under Chapter 11. Unfortunately, more and more solvent businesses are taking advantage of the system and filing for bankruptcy protection in order to accomplish goals that would otherwise not be permissible, such as shedding undesirable leases.

In addition, many U.S. bankruptcy judges and trustees are not abiding by existing rules that were enacted by Congress to protect shopping center owners. As a result, many shopping center owners are losing control over their own properties, neighboring tenants are losing business, retail employees are losing jobs or suffering reduced working hours, and local economies are being threatened.

SHOPPING CENTERS NEED SPECIAL PROTECTION UNDER THE BANKRUPTCY CODE

Bankruptcies pose unique risks and hardships to shopping center owners that are not faced by other creditors because such owners are *compelled creditors* to their retail tenants. As a compelled creditor, a shopping center owner must, under the Bankruptcy Code, continue to provide leased space and services to its debtor tenants without any real assurance of payment or knowledge as to whether or when its leases will be assumed or rejected or whether its stores will be vacated.

On the other hand, trade creditors can decide for themselves whether or not they want to continue providing credit to its bankrupt customers for goods or services. Banks and other lenders are not obliged to continue making loans to their clients once they file for bankruptcy. Utility companies can demand security deposits before they provide additional services to their customers. In fact, some judges are granting "critical vendor motions" made by certain creditors that allow them to receive their pre-petition claims (before all other creditors) in exchange for agreeing to provide their goods or services to the debtor during bankruptcy.

Another element unique to shopping center owners is the interdependence and synergy that exists between a shopping center and its tenants. Owners carefully design a "tenant mix" for each of its shopping centers in order to maximize customer traffic from its market area. The tenant mix includes tenants based on their nature or "use", their quality, and their contribution to the overall shopping center, and is enforced by lease clauses that describe the required uses, conditions and terms of operation. Such clauses are designed to prevent an owner from losing control over its own property and to maintain a well-balanced shopping atmosphere for the local community.

For example, an owner and a retailer may enter into an agreement that restricts the tenant, or an assignee, from changing its line of business to one that competes with another store in the same shopping center. When a use clause is ignored during bankruptcy proceedings, the delicate retail balance and synergy that has been painstakingly achieved by an owner with its tenants is disturbed and can deal a devastating blow to the entire shopping center, and to the community at large.

Acknowledging that shopping center owners are in a truly unique position once one of its tenants files for bankruptcy, Congress enacted special protections in Section 365 of the Code in 1978 and 1984. Unfortunately, many of these laws either have not been enforced or have been liberally construed against shopping center owners beyond Congress' original intent.

LEASES NEED TO BE ASSUMED OR REJECTED WITHIN A REASONABLE, FIXED TIME PERIOD

Under Section 365(d)(4), tenants have 60 days after filing for bankruptcy to assume or reject their leases. If additional time is needed, the court may extend the time period "for cause". Unfortunately, in most cases, the "for cause" exception has become the rule. As a matter of practice, bankruptcy judges routinely extend the 60-day period for several months or years.

In many instances, debtors do not have to decide what they plan on doing with their leases until their plans of reorganization are confirmed. Some debtors are even permitted to make such decisions after the date of confirmation. In a significant current case, Kmart has filed a motion to extend the time period to assume or reject their leases to 270 days after confirmation of their plan of reorganization, which would be well in excess of two years from their original filing.

As a result, the stores of these bankrupt retailers often remain closed for long periods of time, casting a dark shadow on the entire shopping center. Even if a shopping center owner receives rent from the bankrupt tenant during this period, a vacant store usually creates a negative impact on the other stores in the shopping center. Not only do the neighboring stores suffer reduced traffic and sales, but the owner, by virtue of percentage rent clauses that have been written into their leases, suffers reduced percentage rent income from its other tenants.

To make matters worse, the owner is unable to make arrangements to lease out the vacant space to another potential tenant since the bankrupt retailer is not required to inform the owner whether it plans to assume or reject the lease. It is this uncertainty that is most frustrating to shopping center owners. They, and the rest of the shopping center, are essentially kept in limbo until the debtor, or the debtor's trustee, makes a decision to assume or reject its lease. Owners are not attempting to pressure debtors to reject their leases. Instead, they simply want a determinable period of time for their bankrupt tenants to assume or reject their leases.

The current situation is clearly unfair to shopping center owners and has to be remedied. While we realize that 60 days in most cases is not enough time for a bankrupt retailer to decide which of its leases it wants to assume or reject, we strongly believe that a reasonable, *fixed* time period must be created so an owner, and the rest of the tenants in the shopping center, have certainty as to when a lease of a vacant store will be either assumed or rejected.

One must remember that, in most cases, a debtor can decide when it files for bankruptcy protection. Retail chains do not suddenly decide they will file for bankruptcy. They typically review their economic situation well in advance of filing a bankruptcy petition. Retailers and their advisors have a pretty good indication even before they file for bankruptcy which leases they want to assume and which they want to reject since it is often the very reason they are filing for bankruptcy.

Section 404(a) of H.R. 975 would require a debtor tenant to assume or reject its leases within 120 days after filing for bankruptcy. Prior to the expiration of the 120 days, a judge could extend this time period for an additional 90 days upon the motion of the trustee or owner "for cause". Additional extensions could be granted only upon the prior written consent *of the owner.*

By requiring an owner's consent for additional extensions after the initial 120-day and court-extended 90-day periods, shopping center owners would retain a certain degree of control of their property if a tenant has not decided to assume or reject its leases within 210 days. Owners would often be amenable to extending the time period for assumption or rejection for a certain length of time if it appears to be in the best interest of both parties.

While ICSC believes that a total of 120 days (including a court extension "for cause") is ample time for retailers in bankruptcy to make informed decisions as to which leases should be assumed and which should be rejected, to the extent the other shopping center provisions listed below are included in the final package, we would support this provision of H.R. 975.

"USE" CLAUSES NEED TO BE ADHERED TO BY TRUSTEES UPON ASSIGNMENT

As mentioned above, a well balanced "tenant mix" helps create the character and synergy among the various tenants of a shopping center. A lease's "use" clause is specifically designed to maintain this tenant mix, and is supposed to be adhered to upon assumption or assignment. Unfortunately, a growing number of judges are allowing trustees to assign shopping center leases to outside retailers in clear violation of existing use clauses and Code Sections 365(f)(2)(B) and 365(b)(3).

For example, there was recently a case involving a children's educational retailer in the Boston-area in which the judge allowed the trustee to assign two of its unexpired leases to a jeweler and a candle store, even though another children's educational retailer offered bids, albeit lower ones, on those leases. As a result, the shopping center owner lost the ability to maintain an educational store in his center—a major draw to many of its customers.

Use clauses are mutually agreed-upon provisions that are intended to direct the use of a particular property to a particular use. They do not prevent the assignment of a property to another retailer; however, the new tenant is supposed to adhere to the lease's use clause.

Congress has already recognized in the Bankruptcy Code that a shopping center does not merely consist of land and buildings. It is also a particular mix of retail uses which the owner has the right to determine. Thus, Section 365(f)(2)(B) already requires that a trustee has to obtain adequate assurance that a lease's use clause will be respected before he or she can assign the lease to a third party. Section 365(b)(3)(C), defining "adequate assurance", states that ". . . adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance . . . that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as radius, location, *use*, or exclusivity provision. . . ."

Yet, a number of bankruptcy judges have ignored this requirement. This abuse of the Bankruptcy Code must end. Section 404(b) of H.R. 975 would amend Section 365(f)(1) to make it crystal clear to all trustees that the shopping center provisions contained in Section 365(b), including that relating to adequate assurance that use clauses will be respected, must be adhered to before they can assign leases to other retailers.

SHOPPING CENTER OWNERS NEED GREATER ACCESS TO CREDITORS' COMMITTEES

Another growing concern of the shopping center industry is the lack of appointments by many U.S. trustees of shopping center owners to creditors' committees during bankruptcy proceedings. A creditors' committee is the key decision-making body in a bankruptcy case as it helps formulates how and when a debtor is going to reorganize its business. In addition to having a vested interest in the outcome of a bankruptcy case, a shopping center owner can provide valuable knowledge, insight and perspective to a creditors' committee in order to assist in the creation of a successful reorganization plan.

Under current law, U.S. trustees are authorized under Section 1102(a)(1) to appoint a committee of creditors holding unsecured claims. Unfortunately, many trustees have excluded shopping center owners from these committees, even if they qualify to serve under Section 1102(b)(1). This section states that a creditors' committee ". . . shall ordinarily consist of the persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented on such committee . . .".

Even in cases where an owner is not one of the seven largest pre-petition creditors, it usually is one of the seven largest post-petition creditors due to damage claims from rejected leases. A retailer may have been making timely lease payments up to the time it filed for bankruptcy; however, if it later defaults on payments (which it is obligated to make) or decides to reject some or all of its leases, the shopping center owner usually has very large potential rejection claim damages. Certainly, such an owner should be entitled to participate on these creditors' committees.

Although bankruptcy judges currently may order the appointment of additional committees to assure adequate representation of creditors, only the trustees are actually authorized to appoint such committees. Therefore, the discretion to add shopping center owners to creditors' committees is solely vested with the U.S. trustees. Section 405 of H.R. 975 would also give this discretion to bankruptcy judges as it would permit them, after receiving a request from an interested party, to order a change in the *membership* of a creditors' committee to ensure the adequate representation of creditors.

NON-MONETARY DEFAULTS NEED TO BE CURED BEFORE A LEASE CAN BE ASSUMED

Under Section 365(b)(1)(A) of the Bankruptcy Code, a trustee may not assume an unexpired lease unless he or she cures, or provides adequate assurance that he or she will promptly cure, all existing monetary and non-monetary defaults. This provision was enacted by Congress to ensure that existing leases are adhered to before they may be assumed and later assigned to another tenant. Unfortunately, some judges are allowing leases to be assumed and assigned despite the fact that such leases remain in default.

Section 328 of H.R. 975 would amend existing law by providing that non-monetary defaults of unexpired leases of real property that are "impossible" to cure would not prevent a trustee from assuming a lease. Unlike monetary defaults, certain non-monetary defaults are impossible to cure. For example, a vacant store can later be reopened; however, the default (the vacating of the store) can never be fully cured since it is impossible to reopen the store during the time it was left vacant.

However, Section 328 also provides that ". . . if such default arises from a failure to operate in accordance with a *nonresidential* real property lease, then such default shall be cured by performance at and after the time of assumption in accordance with such lease, and pecuniary losses resulting from such default shall be compensated . . .". Therefore, a trustee would be able to assume the lease of a vacant store so long as its non-monetary defaults are cured (e.g., the store is reopened) *at and after* the time of assumption. ICSC supports this provision since it would require trustees to abide by the terms of a commercial lease agreement upon its assumption.

A REASONABLE ADMINISTRATIVE PRIORITY FOR RENTS SHOULD BE ENACTED

Under current law, post-petition rents are treated as an administrative priority until a lease is assumed or rejected under Section 365(d)(3). If a lease is rejected, post-rejection rents are treated as an unsecured claim under Section 502(b)(6), which usually limits the claim to one year's rent. The Bankruptcy Code, however, does not specifically address claims resulting from nonresidential real property leases that are assumed and subsequently rejected.

However, in a 1996 U.S. Court of Appeals case, *Klein Sleep Products*, the court held that *all* future rents due under an assumed lease, regardless of whether it is subsequently rejected, should be treated as an administrative priority and not limited by Section 502(b)(6). As a practical matter, shopping center owners prefer to lease their property to operating retailers as soon as possible to maintain a vibrant center and collect rent, rather than maintain a vacant store whose unpaid rents are treated as an administrative priority.

Section 445 of H.R. 975 would treat rents due under an assumed and subsequently rejected lease as an administrative priority for two years after the date of rejection or turnover of the premises, whichever is later, "without reduction or setoff for any reason except for sums actually received or to be received from a nondebtor". Any remaining rents due for the balance of the lease term would be treated as an unsecured claim limited under Section 502(b)(6).

While ICSC prefers that rents due under an assumed and subsequently rejected lease be treated as an administrative priority for three years, and that any remaining rents due under the lease be treated as an unsecured claim *not* limited under Section 502(b)(6), we accept this provision as a reasonable compromise so long as the other shopping center provisions listed above are included in the final package.

CONCLUSION

ICSC appreciates the opportunity to present its views on this very important matter, and would like to thank this Subcommittee, as well as the full Committee and Chairman Sensenbrenner, for all of its work over the past few years to enact bankruptcy reform legislation. We are hopeful that this bill will pass both the House and Senate soon and be signed into law by President Bush.

PREPARED STATEMENT OF ROBIN SCHAUSEIL

Good afternoon.

Please let me introduce myself to you: my name is Robin Schauseil and I am the President of the National Association of Credit Management (NACM). I am pleased to present the perspectives of the National Association of Credit Management (NACM) to you regarding H.R. 975, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2003. I want to extend our thanks to you for affording NACM the opportunity to share its views with you.

Founded in 1896, NACM is a 24,000 member international trade association composed of corporate credit executives, who represent 23,000 different businesses. NACM represents American business credit professionals from all 50 states, and is proud to have member representatives from more than 30 countries around the world. NACM's mission is the constant improvement and enhancement of the business trade credit profession.

The NACM membership is comprised of American businesses of all kinds: manufacturers, wholesalers, service industries, and financial institutions. The profile of the NACM members ranges from the smallest businesses to a majority of the Fortune 500. NACM's members make the daily decisions regarding the extension of unsecured business and trade credit from one company to another. In fact, business credit executives provide billions of dollars each day through the extension of business and trade credit among companies around the world.

NACM is very pleased to support H.R. 975 because of the commercial bankruptcy laws it improves. My comments will only focus on the commercial issues raised in the proposed legislation.

SMALL BUSINESS CHAPTER 11 REORGANIZATIONS

Subtitle B of the legislation contains the provisions dealing with small business reorganizations. NACM supports the efforts to create substance and procedure to expedite the administration and conclusion of reorganization cases for small businesses. These provisions were originally offered to proposed bankruptcy legislation as part of the recommendations of the National Bankruptcy Review Commission (NBRC). The NBRC conducted several hearings and received considerable testimony regarding the problems that small businesses have in bankruptcy proceedings. The premise behind the need for small business reorganization proposal is simple: the faster a small business can enter and exit the bankruptcy process the better the outcome is for all affected parties. Languishing in bankruptcy court strips assets from the debtor that could be otherwise be dedicated to a plan for reorganization that creditors could approve. Lengthy delays also deny creditors any hope of recovery of payment for goods or services extended to the debtor should the case need to be converted to a Chapter 7.

Studies and statistics continue to dramatically show that many small businesses have been unable to have a plan of reorganization approved because of the time and expense that languishing in Chapter 11 causes. The current lengthy process of a Chapter 11 proceeding makes it extremely difficult for small business debtors to viably continue operations, balancing employment and service levels, paying taxes, and fully or partially satisfying claims of creditors. These delays create even more challenges for the small business: its own customers are fearful of the future for the small business in distress, impacting future business transactions.

Testimony provided to the NBRC indicated that in a high percentage of cases, small business debtors were unable to produce a check register at the first meeting with creditors. Additionally, the overwhelmingly high conversion rate for small business debtors from Chapter 11 reorganization to Chapter 7 liquidation indicates that most small businesses should have been in Chapter 7 to begin with; greatly reducing court expenses, attorney fees and unclogging bankruptcy court dockets.

The model contemplated under this legislation is patterned after an expedited procedure used in the federal bankruptcy court in eastern North Carolina. Under the local rules devised by Bankruptcy Judge Thomas Small, the period of time in which small business cases are adjudicated has dramatically been reduced. Most importantly, there have been no measurable deleterious impact on any small businesses to have a plan of reorganization presented and approved by the court. In fact, Judge Small's statistics indicate that a higher percentage of small business debtors are able to have their plans of reorganization approved than is the national average.

If this legislation is enacted, it could have the effect of helping to streamline the bankruptcy process by eliminating much of the time consuming issues that currently involve small businesses. Moreover, given the very low rate of successful reorganizations of businesses that file Chapter 11, the improvements contained in the legislation to the reorganization process for small businesses should dramatically affect the reorganizations on a positive basis. Given that the overwhelming majority of business bankruptcy cases are small businesses, the timely consideration of such cases will have the effect of ameliorating the huge backlog on the court dockets. Finally, because these expedited procedures will apply to only those businesses with less than $2 million in debts, the real benefit relief will be extended to genuine small businesses.

PREFERENCES

NACM is equally supportive of the provisions contained in Sections 409 and 410 of the bill to correct inequities that currently exist with respect to preferential transfers. While NACM supports the concept of the equality of treatment of creditors, the current statute creates an environment for the feeding frenzy of trustees, attorneys and others not part of the creditor body at the expense of vigilant trade creditors, with no ultimate benefit being derived by creditors of the bankrupt estate.

Under current law, instead of having the trade creditor class be the beneficiary of preferential transfer recoveries, the funds that are recovered are paid to the professionals who are employed to recover them. Specifically citing small preference actions, statistics provided to the NBRC showed that bringing preference actions for $5,000 or less does nothing to substantially enhance distribution to creditors or restore funds to the debtor's estate. Again, it was shown that these activities do, however, generate substantial attorney expenses. This has resulted in a large "breakdown" of the system, forcing vigilant trade creditors to expend considerable sums for representation only to learn that the ultimate beneficiaries of the recoveries do not correlate to those intended by the original legislation.

The changes address problems in two important areas. First, the clarification of what constitutes a transaction conducted under the ordinary course of business removes the doubt and uncertainty that has permeated case law and created difficulties for the ordinary transaction of business with distressed debtors. The mere fact that a business may be in financial distress should not create an impediment to ordinary course dealings. Indeed, if this were to be the case, it would only precipitate additional bankruptcy filings. The change created by Section 409 of the legislation clarifies that creditors willing to continue to extend credit to financially distressed businesses will not be penalized.

Second, the changes with respect to when and where certain preference actions may be filed are equally beneficial. Bringing preference actions in distant courts only forces unreasonable capitulation by creditors when they may have legitimate defenses but choose not to make them because of the cost involved in securing representation in those courts. These changes will also afford protection to those creditors who act in good faith when dealing with financially distressed businesses.

Sections 409 and 410 are consistent with the recommendations of the NBRC that took great care and time in examining these issues. NACM agrees with the NBRC that these changes will help to create a "level playing field" with respect to bankruptcy administration. Additionally, these provisions, if enacted, will eliminate unnecessary and unproductive litigation that can affect the already overburdened bankruptcy court system.

CREDITOR COMMITTEE COMPOSITION

NACM wholeheartedly supports the language in Section 405 which permits the court to change the membership of the creditors committee if the change is necessary to ensure adequate representation of creditors and equity security holders. Presently, there is no judicial redress in the event that, for whatever reason, a creditors committee that is appointed does not adequately represent the creditors as a whole. This provision correctly provides for appropriate judicial oversight of a very important component of the bankruptcy reorganization process.

RECLAMATION

NACM also strongly endorses Section 1227 of H.R. 975 to modify specific reclamation provisions of the bankruptcy code. Currently, when dealing with the reclamation of goods, the bankruptcy code does not protect the rights of manufacturers and distributors in most cases.

Some of the legal and practical problems that have been created are the following:

1. Vendors do not know of the filing of a bankruptcy proceeding in sufficient time in order to file a reclamation notice.
2. Current law permits reclamation only when the goods are still in the possession of the debtor when notice is received. With multiple operations of a debtor, this becomes impossible to prove or verify.

3. The rights of secured creditors pre-empt any reclamation rights.
4. There is no sanction on the debtor for failing to comply with the reclamation notice.
5. Vendors are required to immediately hire counsel in order to protect reclamation rights, only to be delayed by the lengthy court proceedings.
6. The procedure gives the debtor opportunities to force concessions from vendors with respect to post-petition credit in order to gain concessions with respect to reclamation.
7. Traditionally, manufacturers, distributors and other vendors receive little benefit from the current reclamation law.

Section 1227 would rectify these problems by creating a new approach for the treatment of reclamation claims, providing an option for a creditor to consider in exerting a reclamation claim. The creditor would be afforded a 45-day period from the date the debtor received the goods for the return of goods under a reclamation claim. Alternatively, a creditor could choose to have an administrative priority for all goods delivered within 20 days of the filing. Under the legislation, the creditor would be able to use only one of these options, not both.

Simply increasing the reclamation period from 20 to 45 days will not solve the problem. While this initially appears to protect vendors, it may have the opposite effect. If the reclamation date reaches too far back, Chapter 11 debtors will not be able to confirm a Chapter 11 Plan because of the burden of administrative claims that they may be required to be paid on confirmation as a result of the reclamation demands. (Under the code, all administrative expenses must be paid in full before a plan can be confirmed.) Placing unreasonable burdens on debtors in order to effect a confirmation does not protect the interests of creditors in the long run.

NACM believes that the following will be the benefits of such a change:

1. All vendors of goods will be protected.
2. There will be no "race" to the courthouse to file notices.
3. Vendors will not be adversely prejudiced if they do not know of the bankruptcy filing during the first days following the filing.
4. All vendors of goods will be entitled to an administrative priority claim for the goods actually received by the debtor within 20 days of the filing of the bankruptcy case. Thus, debtors contemplating the filing of a bankruptcy proceeding will have a deterrent to "loading up", as they will know that in order to confirm any Chapter 11 Plan, they will have to pay in full for all goods received within the 20-day period at the time of confirmation, not just those that are in inventory when notice is received.
5. This does not in any way alter the rights of secured creditors, so there should be no opposition by lenders. It does, however, impose a payment obligation on the Debtor which may have to be funded by the lenders in order for a Chapter 11 Plan to be confirmed.
6. Solvency or insolvency of the debtor is no longer an issue to be considered or litigated.
7. The issue of whether the goods are on hand and are identifiable is no longer an issue to be considered or litigated.

RETAIL LEASE ASSUMPTION

Previously, NACM has expressed its concern with the language contained in Section 205 of the bill. While NACM clearly supports the most expeditious administration of bankruptcy cases as possible, artificial deadlines should not be created merely to enhance the rights of one constituency. Artificially limiting a debtor's right to assume or reject the lease at 120 days may not always be in the best interest of all creditors and other parties in interest. There is no problem in establishing a deadline which should be the "normal" deadline, but there must be flexibility built into the law to permit the court to modify the deadline if facts and circumstances so warrant.

The current Section 205 creates a burden upon large retailers and other similar businesses which may lead to decisions which have a long term effect on the reorganization process being hastily made. For instance, had this law been enacted and applied to the K-Mart bankruptcy filing, one could not comprehend the magnitude of the difficulties that would have developed for that debtor. NACM urges that the proposed legislation be modified to provide that the court may extend the period to be determined under the amendment within the discretion of the court.

The National Association of Credit Management appreciates this opportunity to provide the perspectives of its members to the Subcommittee on the issue of bankruptcy reform. We believe that need for bankruptcy reform, especially in the area of commercial practices, is long overdue. We applaud the Chair and members of the Committee for their diligence in attempting to again move this legislation that is so very vital to America's business community.

The Honorable Chris Cannon
Chairman
Subcommittee on Commercial and Administrative Law
House Judiciary Committee
B353 Rayburn House Office Building
Washington, DC 20515

March 4, 2003

Dear Chairman Cannon:

I am writing on behalf of the National Association of Federal Credit Unions (NAFCU), the only national trade association that exclusively represents the interests of the nation's federal credit unions, to express our support for H.R. 975, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2003" and to thank you for convening this hearing today on this important issue to our nation's credit unions.

In the twelve-month period that ended on December 31, 2002, over 1.5 million consumers filed for bankruptcy; approximately 250,000 of those consumers were credit union members. We are pleased to see that Congress has recognized this trend and has taken action in an attempt to alleviate this problem.

Credit unions are member-owned not-for-profit institutions that serve a broad and diverse membership base, including many members of low and moderate means. Because of their cooperative form of ownership credit unions have no choice but to pass bankruptcy losses on to financially responsible members through increased interest rates on loans or decreased dividend rates on savings. As the number of bankruptcy filings continues to rise, bankruptcy losses have a disproportionately heavier impact upon fiscally responsible credit union members than they do on the customers of for profit financial institutions.

Three issues have risen to the top of NAFCU's agenda with regard to bankruptcy reform. First, require the courts to conduct a "means" test to determine whether debtors who file for total elimination of their debts under Chapter 7 of the Bankruptcy Code have the resources to repay some portion of their debt, in which case they should be required to file under Chapter 13 or be dismissed out of bankruptcy. Second, require mandatory financial education for all filers. Credit unions have a history of educating their members in financial matters, including the wise use of credit and the value of systematic savings. Finally, preserve the right of voluntary reaffirmations for credit union members. Credit unions traditionally have higher reaffirmation rates than many other lenders, partly because their members realize that credit unions are cooperatives, and offer them low interest rates on loans and high dividend rates on savings.

NAFCU supports meaningful reform of the bankruptcy code that brings about both responsible lending as well as responsible spending. NAFCU believes that the legislation before the Subcommittee today will go a long way toward making appropriate and long-needed reforms to the bankruptcy system.

We are pleased to see that the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2003" includes the three important provisions that NAFCU believes are necessary in any reform effort: preservation of voluntary reaffirmation authority for credit union members; a "means" test so debtors who can repay some part of their debt do; and, mandatory debtor education programs.

Furthermore, I would like to draw your attention to one additional issue that has come to my attention over the last several months and that we hope can be included as this legislation moves forward. As you know Title IX of H.R. 975 would allow for efficient and expedient settlement of bilateral netting agreements in most situations. Recognizing the interdependence of overnight and money market transactions, the financial services industry considers bilateral netting essential to ensuring that the insolvency on one institution does not have a domino effect on other institutions that could lead to disruptions in the money supply. I urge you to support both the bilateral netting provisions and their extension to federally insured credit unions to the same extent as federally insured banks and thrifts.

It is our hope that H.R. 975 will move swiftly through the legislative process and ultimately become law. If you or your staff should have any questions or would like further information, please do not hesitate to contact NAFCU's Senior Legislative Representative, Murray Chanow, or me at (703) 522-4770. Thank you for giving me this opportunity to share NAFCU's views on this important matter.

Sincerely,

Fred R. Becker, Jr.
President/CEO

cc: The Honorable James Sensenbrenner

PREPARED STATEMENT OF THE NATIONAL MULTI HOUSING COUNCIL/ NATIONAL APARTMENT ASSOCIATION JOINT LEGISLATIVE PROGRAM, NATIONAL LEASED HOUSING ASSOCIATION, MANUFACTURED HOUSING INSTITUTE AND THE INSTITUTE OF REAL ESTATE MANAGEMENT

Chairman Sensenbrenner and members of the Committee, the undersigned organizations thank you for this opportunity to share the views of rental housing providers as you consider the Bankruptcy Abuse Prevention and Consumer Protection Act of 2003 (H.R. 975).

The National Multi Housing Council represents the principal officers of the apartment industry's largest and most prominent firms. The National Apartment Association is the largest national federation of state and local apartment associations. NAA is comprised of 163 affiliates and represents more than 30,000 professionals who own and manage more than 4.6 million apartments. NMHC and NAA jointly operate a federal legislative program and provide a unified voice for the private apartment industry.

For the past thirty years, the National Leased Housing Association (NLHA) has represented the interests of developers, lenders, housing managers, housing agencies and others involved in providing federally assisted rental housing. Our members are primarily involved in the Section 8 housing programs—both project-based and tenant-based. NLHA's members provide housing assistance for nearly three million families.

The Manufactured Housing Institute (MHI) is the national trade organization representing all segments of the factory-built housing industry. MHI serves its membership by providing industry research, promotion, education and government relations programs, and by building and facilitating consensus within the industry.

The Institute of Real Estate Management (IREM), an affiliate of the NATIONAL ASSOCIATION of REALTORS, is an association of property and asset managers who have met the strict criteria in the areas of education, experience, and ethics. Today, IREM members manage 24%, or 6.2 million of the nation's conventionally financed apartment units, and 1.4 million units of federally assisted housing.

Bankruptcy reform has been a long time in coming. More than 1,800 real estate professionals, mostly small businesses, have written to the National Bankruptcy Review Commission and Congress since 1995, providing compelling evidence of the need for reform. Over the past several years, the rental housing industry has witnessed an increased number of residents who manipulate the Code in order to live in their apartments without paying rent. The source of this abuse is the Code's automatic stay provision. *The undersigned organizations urge Congress to enact the balanced reforms found in the Bankruptcy Abuse Prevention and Consumer Protection Act (H.R. 975) and thereby reduce opportunities for abuse by those who file for bankruptcy in order to "live rent-free."*

Reform is more critical now than ever. According to a recently released report by the Administrative Office of the U.S. Courts, new bankruptcy filings continue to break records. The latest data show that well over 1.57 million bankruptcies were filed in 2002, up 5.7 percent from the previous record set in 2001. *Non-business filings made up 97.6 percent of those filed last year.*

Enactment of beneficial bankruptcy reform is long overdue. The widespread bipartisan support for bankruptcy reform, as evidenced by the more than 50 Members of Congress who have already joined as cosponsors of H.R. 975, reflects strong public opinion that the Bankruptcy Code can and must be made to work better as it becomes a more common means for Americans to restructure their finances.

In particular, the undersigned organizations strongly urge Congress to get the job done and remove the loopholes in the U.S. Bankruptcy Code that allow resident debtors who no longer have a right to remain on the premises to stay after declaring bankruptcy. Rental housing residents who file bankruptcy primarily to evade their lease obligations impose significant economic losses on apartment owners (98% of which are small businesses) and prevent other renters desiring to move into the unit from doing so. Attorneys continue to advertise to rental housing residents that the Bankruptcy Code is a means to live "rent-free" for months at a time. In other cases, the automatic stay significantly delays the removal of rental housing residents who are using drugs or threatening property or other residents and guests.

These "free ride" examples—more are detailed below—are abuses of the Bankruptcy Code's "fresh start" principle. If the proper reforms are made, small business apartment owners would regain timely possession of their property and lower-income families would have quicker access to scarce affordable housing.

H.R. 975 includes an important, balanced step to improving the automatic stay for the benefit of rental housing providers and residents alike. Section 311 is the result of extended negotiations between Senators Jeff Sessions (R-AL) and Russell

Feingold (D-WI) that have yielded an agreement that balances the concerns of residents in bankruptcy with property owners seeking to reclaim their property. The undersigned organizations are appreciative of the significant work that these members in particular invested to reach agreement on the language of this section. While the agreement is not everything that the undersigned organizations have sought, we believe it is a fair and balanced compromise that will yield important benefits to the availability of affordable and market-rate rental housing in this country.

Before Congress and the National Bankruptcy Review Commission, NMHC/NAA have catalogued numerous examples of frivolous bankruptcy filings by residents since the 1990s. Three examples out of hundreds previously presented are recounted here.

An Army Colonel leased his home to a couple with three small children while he was stationed overseas. Before leasing the property, the firm that managed the Colonel's property ran a credit check and found that the couple had a joint income well in excess of the monthly rent. There was nothing in the credit report to indicate what the Colonel and his family would face over the next two years.

Over the course of the lease term, the residents occasionally made late payments, but their rent was always paid. Eventually, however, the residents failed to pay their rent despite several notices. After the management firm sent them a three-day notice to vacate for non-payment of rent, the firm decided to give the residents yet another chance and work out a repayment schedule.

What the management firm representatives found when they approached the house was shocking: It was in shambles. The oven door had been ripped off its hinges; there were large and numerous holes in the sheet rock, some with silk flowers stuck in them; you could not tell what color the carpet was due to the trash and food strewn on it; the toilet in the upstairs bathroom had been ripped out of the floor; the air conditioning compressor was in pieces; several windows were broken; and the downstairs bathroom door had been kicked in and was hanging by one hinge. The management firm gave the residents a final three-day notice to vacate for non-payment of rent. The residents never responded to that notice, and after the required three-day notice period, the managers filed for eviction.

Even after the eviction filing, the residents failed to pay their rent. Finally, a judge granted the eviction and ruled that the residents would have to pay all overdue rent. The residents then claimed that they were financially unable to post the required bond to appeal. At a hearing on that claim, the judge confirmed that the residents had both the income and the assets to post the appeal bond and granted the management firm a writ of possession. *The next day, however, the managers were notified that the residents had filed for bankruptcy, effectively stopping the eviction process because of the Code's automatic stay provision.*

Following multiple failed attempts to negotiate a settlement, the management firm filed for relief from the automatic stay. The residents then demanded a hearing on that motion. *During the three-month period before the hearing, the residents lived in the house rent-free.* Seven months after the ordeal began, and four months after the bankruptcy court assumed jurisdiction, the judge agreed to a settlement that directed the residents to move out and repair all damages. When the residents had not moved out in accordance with the settlement, the court issued another writ of possession for the next day. *Finally, the resident's possessions were removed from the house and their bankruptcy petition was dismissed. The overall cost to the Colonel (the owner of the property) was approximately $21,000.* By the time the residents were finally evicted, the Colonel had to borrow on his life insurance, sell assets, and run up the balance on his credit cards. When the house was sold shortly thereafter, the Colonel received nothing.

Sheri Perez, an owner of 8 rental units in Costa Mesa, CA, had renters in two of the units declare bankruptcy in the same month. "I know for a fact that these two tenants used the automatic stay and filing bankruptcy just to get out of paying any rent," she wrote to the National Bankruptcy Review Commission. Each of the renters owed two months' rent when they moved out—25 percent of Ms. Perez's entire rental income for those months.

Dan Snell, a property owner in Temple City, CA who manages 50 rental properties, recounted the loss sustained on a 10-unit property he manages in his letter to the Bankruptcy Review Commission. A resident who was being evicted for selling drugs on the property declared bankruptcy. Before the bankruptcy court ordered relief from the automatic stay to permit Mr. Snell to remove this drug-seller, Mr. Snell had to wait two months for the court to permit the eviction to proceed. "During that period," wrote Mr. Snell, "the tenant continued his illegal activities and three of the other tenants moved out because of that activity. This episode cost the owner several thousand dollars in legal fees and lost rent."

These are just three examples of how abusive residents manipulate the Bankruptcy Code to live rent-free.

The bankruptcy system was established to give individuals a second chance, not to be manipulated as a tool by residents to avoid eviction and live rent-free at the expense of rental housing providers and depriving others from moving into that rental unit.

The undersigned organizations ask that the members of this Committee and the U.S. House of Representatives pass H.R. 975. We urge you to close the automatic stay loophole to ensure the viability of small business rental housing providers and the affordable and market-rate housing they provide.

NMHC/NAA Joint Legislative Program
1850 M Street NW #540
Washington, DC 20036

National Leased Housing Association
1818 N Street NW #405
Washington, DC 20036

Manufactured Housing Institute
2101 Wilson Blvd. #601
Arlington, VA 22201

Institute of Real Estate Management
700 11th Street NW
Washington DC 20001

Prepared Statement of Dean Sheaffer

Good afternoon. My name is Dean Sheaffer. I am Senior Vice President of Credit and CRM for Boscov's Department Stores and Chairman of the Pennsylvania Retailers' Association. Boscov's is primarily a Mid Atlantic department store chain. In addition to Maryland and New Jersey, we have 2 stores in Delaware, 3 stores in New York, and more than two dozen stores in our home state of Pennsylvania. I am testifying today on behalf of the National Retail Federation. I would like to thank Chairman Cannon and Ranking Member Nadler for providing me with the opportunity to testify before this distinguished committee.

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 2002 sales of $3.6 trillion. NRF's members and the consumers to whom they sell are greatly affected by the recent surge in consumer bankruptcies.

Mr. Chairman, I have testified several times over the past three Congresses on the issue of bankruptcy reform. Today, I am here to let you know that Bankruptcies are still out of control. In fact, they are even more out of control than ever. Nationally, we reached a record high of more than 1.5 million consumer filings last year. In fact, between 1995 and 2002, consumer filings rose by seventy percent (70%). In Pennsylvania where we are based, consumer bankruptcies more than doubled in that same time period. As a business, we didn't even get a reprieve from filings in the late 1990s when the economy was registering record expansion and the nation was enjoying near full employment. In 1996, annual consumer bankruptcies topped 1 million for the first time in history and they have only continued to rise.

At Boscov's, we have approximately 500,000 billed credit accounts. In 2002 we closed or reduced the credit limit or took other pre-emptive action on about 40,000 accounts in direct response to increased bankruptcies. Notably, Boscov's combined January and February 2003 bankruptcy write-off was more than 22% higher than January and February of 2002.

Part of the problem is that higher income people, who do not really need Chapter 7 relief, are using that chapter to wipe out their debts regardless. These are not people at the margin. This is plain misuse. Tightening credit is a very blunt instrument. It hurts people at the margin by limiting their access to credit—but it does not get at the higher income individuals who are filing bankruptcies of convenience. That is why we need this legislation, to target bankruptcy misuse.

Mr. Chairman, I know that in 2003 we are living in tougher economic times than just a few years ago, but I would like the opportunity to put all the numbers in perspective. Consumer bankruptcy filings are almost five and one-half (5½) times higher than they were in 1980, a time of generally worse economic conditions. Interestingly, despite front-page headlines reporting the Enron collapse, the World.com bankruptcy and the K-mart reorganization, overall business bankruptcies have been down for nine of the last ten years. In fact, they have been cut in half from an all-time high of 71,000 in 1991. It does not, then, make sense that consumer bankruptcies have consistently continued to skyrocket. And, if the current rate of filings holds within the next decade, 1 in every 7 American households will have filed for bankruptcy. Mr. Chairman, the system is seriously, seriously flawed.

It is estimated that over $40 billion was written off in bankruptcy losses in 2000, which amounts to the discharge of at least $110 million every day of that year. This money does not simply disappear. The cost of these losses and unpaid debts are borne by everyone else. When an individual declares bankruptcy rather than pay the $300 they may owe to Boscov's, or the $1,000 dollars they may owe in state taxes or other bills, they force the rest of us to pick up their expenses. Everyone else's taxes are higher, everyone else's credit is tighter, and everyone else pays more for merchandise as a result of those who choose to walk away. Last year, to make up for these losses, it cost each of our Nation's 100 million households several hundred dollars. Estimates suggest this year's number will again be higher—it will be interesting to see the first quarter numbers from 2003 when they are published in the coming weeks. As I noted above, our internal numbers reflect that the tide is still rising.

Now, I want to be clear. We cannot eliminate all of these losses. Some of them are unavoidable. Bankruptcy must remain an option for those who have experienced serious financial setbacks and who have no other means of recovering, especially in these times of economic downturn. The bankruptcy system exists to help those who have suffered a catastrophic accident, illness or divorce, or those who have experienced the loss of a business or job from which they cannot otherwise recover. It is both the safety net and the last resort for people in trouble. The knowledge that the bankruptcy system exists to catch them in a financial fall, even though it might never be used, is important. Finally, most people who file for bankruptcy need relief. We must be very careful to distinguish the average filer, who uses the system properly, from that smaller, but important group of others who misuse the system for their benefit.

It is this trend with which we must be concerned. We believe changing consumer attitudes regarding personal responsibility and inherent flaws in our bankruptcy process have caused many individuals, who do not need full bankruptcy relief, to turn to the system regardless. They use it to wipe out their debts, without ever making a serious effort to pay. Some of this change in usage results from a decline in the stigma traditionally associated with filing for bankruptcy. Some of it results from suggestions by others who urge individuals to use bankruptcy to "beat the system." According to a poll conducted in November, 2002, by Penn, Schoen and Berland, 82 percent of voters say that filing for bankruptcy is more socially acceptable than it was just a few years ago. Whatever the cause, irresponsible filings must be curtailed and consumer attitudes should be altered.

My experience at Boscov's, and that of credit managers at other stores with whom I have spoken, further convinces me that the result of this poll is right on target. For example, for many years we tracked the payment history of those of our customers who carry and use the Boscov's card. The vast majority of our customers pay as agreed. In the past, we would occasionally see customers whose payment patterns were more erratic. This kind of payment history suggested to us that the customer was experiencing some sort of financial difficulty. We would then monitor the account and intervene as necessary, perhaps by suggesting consumer credit counseling or by limiting the customer's credit line to minimize the amount of damage, prior to their experiencing a financial failure.

Today, however, we see a very different picture. Often the first indication we get that an individual is experiencing financial difficulty is when we receive notice of his bankruptcy petition. A 1998/1999 study at Boscov's showed that almost half of the bankruptcy petitions we receive are from customers who are not seriously delinquent with their accounts. It appears that bankruptcy is increasingly becoming a first step rather than a last resort.

Mr. Chairman, consumers must have a good credit history to qualify for and continue to use a Boscov's card. Yet we, and other retail credit grantors, have been receiving bankruptcy filings without warning from individuals who have been solid customers for years. We all experience temporary financial reversals in life. Most of us learn that, if you grit your teeth and tighten your belt a notch, you can get through it. But many people no longer see it that way. The rising bankruptcy filings reflect this.

Part of it is trend can be attributed to increasingly aggressive lawyer advertising. We have all seen the ads on TV by lawyers promising to make individuals' debts disappear. Some do not even mention bankruptcy—they talk about "restructuring" your finances. I question whether these aggressive advertisers inform their clients about the serious downsides of filing for bankruptcy. There are also bankruptcy petition preparers: clerk typists who simply fill out forms for filers. The client may never meet a lawyer. And with the widespread use of the Internet, websites that proclaim "File bankruptcy for as little as $99" are multiplying. I firmly believe these low cost "bankruptcy mills" are part of the problem.

To some degree, the rise in bankruptcy filings can also be attributed to the events as they have played out here in Congress over the past seven years. Mr. Chairman, Ranking Member Nadler, each time this legislation comes close to final passage we see a spike in bankruptcy filings. Individuals are often counseled by attorneys or other bankruptcy professionals to "file quick, before bankruptcy reform becomes law" in order to reap the benefits of a full Chapter 7 discharge. In fact, distortions of this legislation run rampant in the press and elsewhere, and have caused many to believe that they won't be able to file for bankruptcy at all once this reform becomes law. As we all know, this is simply not correct.

At a time when 1 in every 80 households files for bankruptcy, everyone knows someone, or knows of someone, who has recently declared. Many of these individuals keep their house, their car or even their boat. Recent polling suggests that sixty-nine percent (69%) of voters who know someone who has declared bankruptcy support tightening the law. Among these people, another fifty-three percent (53%) support reform because they know that they are bearing the burden of the current system. Furthermore, the same poll shows that fifty-six percent (56%) of all voters strongly favor an income test to ensure that those bankruptcy filers who can afford to pay back part of their debt do so. Mr. Chairman, responsible consumers are clearly getting fed up.

I just want to spend a final few minutes detailing the retail industry's long-standing support for this bill. In 1998, during the 105th Congress, we strongly supported the bill introduced by Mr. Gekas and Mr. Moran, H.R. 3150. It provided a very simple, up front needs-based formula that allowed the overwhelming majority of those who needed bankruptcy relief in Chapter 7 to have it with virtually no questions asked. But for that subgroup of filers, for those higher income individuals who often use Chapter 7 to push their debts onto others regardless of the filer's ability to pay, the up front, needs-based test would have said, "No. Pay what you can afford."

In the 106th Congress we continued to support the conference report that passed both the Senate and House, but was pocket-vetoed by President Clinton during his final days in office. Again, in the 107th Congress, we supported the conference report for H.R. 333. Unfortunately, that bill fell victim to a politically motivated debate over essentially unrelated issues during the final days of the Congress. Like last year, we are deeply concerned that if this heavily negotiated bill is further watered down the intended benefits will be lost. We are also deeply concerned that some will again wish to attach amendments that will act as "poison pills" moving forward. While these issues may deserve consideration, they should stand on their own merit. In the context of this debate, their primary effect is to derail critical and needed changes to bankruptcy law as demonstrated by the November 13, 2002 vote on the House floor.

On behalf of the National Retail Federation, I urge members of Congress to take swift legislative action to address the problems confronting the nation's bankruptcy system. Otherwise, in the not too distant future, we may find that among a large segment of our society, bankruptcy filings will become the rule rather than the exception. If we are not careful, the costs of the rising tide of discretionary filings may tax society's compassion for those in genuine need. We must not allow that to happen. I believe that it is imperative for Congress to pass common sense bankruptcy reform legislation without further amendment, now.

LEGISLATIVE HISTORY OF THE BANKRUPTCY REFORM ACT OF 2002
Subtitle B -- Priority Child Support

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I. HISTORICAL TREATMENT OF SUPPORT DEBTS IN BANKRUPTCY

Bankruptcy law has long recognized the legal and moral importance of the payment of obligations incurred by a debtor for the support of his or her spouse and children. As such, it has striven to avoid having bankruptcy become a haven for those who would avoid such obligations or an inadvertent impediment for those who wish to comply with those obligations. However, the treatment of domestic support in bankruptcy had developed somewhat haphazardly over time as new issues and concerns have been raised and addressed piecemeal. Moreover, the Code had lagged behind in dealing with the changing legal status of payments made to governmental entities for such obligations, specifically whether such payments were to be paid directly to support the child or family of the debtor, or were to be retained by the government because the parent or child was receiving public assistance.

Under current nonbankruptcy law the status of a support obligation may change rapidly as the recipient moves on or off government assistance even though the underlying responsibility to support the child or family is unaltered. Thus, there is little reason for payments of domestic support obligations to governmental entities not to be treated equally with payments of such obligations directly to a parent or child, or for a debtor to have a lesser duty to satisfy those debts.

Prior to the Bankruptcy Reform Act the principle of favored treatment for all domestic support obligations had only been partially recognized in the Code, and there were a number of areas in which bankruptcy filings impacted domestic matters which were not dealt with at all. Accordingly, the Reform Act has undertaken a comprehensive review of all aspects of the treatment of domestic support obligations under the Code to create a coherent and consistent structure to deal with such obligations in bankruptcy.

The following basic principles were employed in drafting the support amendments contained in the Reform Act:

1. Bankruptcy should interfere as little as possible with the establishment and collection of on-going obligations for support, as allowed in State family law courts.

2. The Bankruptcy Code should provide a broad and comprehensive definition of support, which should then receive favored treatment in the bankruptcy process.

3. The bankruptcy process should insure the continued payment of on-going

support and any support arrearage with minimal need for participation in the process by support creditors.

4. The bankruptcy process should be structured to allow a debtor to liquidate nondischargeable debt to the greatest extent possible within the context of a bankruptcy case and emerge from the process with the freshest start feasible.

There were a number of areas under former law where these goals were not met. Support and debts in the nature of support were not treated uniformly in the Bankruptcy Code or by bankruptcy courts. Conspicuously, debts owed to the government and based upon the payment of government funds for the maintenance and support of the children or family of the debtor were not given the advantages which the Code affords to debts payable directly to the family of the debtor. Specifically, support debts assigned or owed to the government on the petition date have not been entitled to any priority under §507(a), have not been protected from loss of their secured status under §522(f)(1)(A), and have been recoverable by the trustee as a preference under §547(c)(7)(A). Conversely, support debts which were not assigned on the petition date were entitled to superior treatment as provided in sections 507(a)(7), 522(f)(1)(A), and 547(c)(7)(A).

Because support debts which are assigned to a governmental entity when a petition is filed may become unassigned during the course of a Chapter 12 or 13 bankruptcy plan, and vice-versa,[1] the disparate treatment of these debts in the Bankruptcy Code makes little sense. A family which is in need of support after assistance terminates certainly should not lose the advantages the Code gives unassigned support simply because the support was assigned on the petition date. The contrary was also true. Governmental entities under former law received the advantages given to the creditor of unassigned support when the support became assigned during bankruptcy. An overriding purpose of Subtitle B is to eliminate substantially such distinctions in the treatment of support obligations.

In addition to the disparate treatment of support debts found in the Code, the courts also drew distinctions with respect to the dischargeability of support debts owed to the government and support debts owed to the parent or child of the debtor. These distinctions were often arcane and technical. To illustrate, if the debts were owed to the government and based upon the payment of public assistance, the dischargeability of such debts turned on the irrelevant circumstance of when the aid was paid. As a result, judgment debts for support based upon the payment of public assistance prior to the date a petition for on-going support was entered could be discharged while an arrearage accrued under an on-going order could not, even when the

[1] The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (frequently referred to as "Welfare Reform") provides that a support arrearage which is assigned when the applicant is granted public assistance may become unassigned when assistance terminated. 42 U.S.C. §657. Since recipients of assistance lose their benefits after 60 months, it is increasingly likely that their status will change during the term of a 3 - 5 year Chapter 12 or 13 bankruptcy plan. See 42 U.S.C. §608(a)(7). Moreover, many recipients of public assistance, encouraged to leave welfare through work incentive programs far earlier than the 60 month limit, may be in the greatest need for repayment of accrued support arrears.

support debts were based on identical criteria.[2] And contributing to a lack of uniformity, the decisional law was not consistent.[3] Moreover, many debts which were incurred by a debtor based upon the responsibility of a governmental entity to provide for the support and maintenance of a child, but which debts were never owed to the child or family of the debtor directly, could be discharged. In particular the following were found to be dischargeable: debts incurred for the costs of maintenance of a child in a juvenile detention facility;[4] debts incurred to support a child who was made a ward of the state;[5] debts for support which had not been reduced to a judgment at the time the bankruptcy petition was filed;[6] and debts for child support and maintenance resulting from the placement of the debtor's children in shelter care facilities.[7] In all of these situations debtors have the same legal, equitable, and moral obligations to provide for the support of their children, but under the peculiarities of former law they could transfer that burden to the taxpayers. This Bankruptcy Reform Act is designed to insure compliance with those obligations, during and after bankruptcy.

II. SUPPORT DEBTS ARE BROADLY DEFINED

Sec. 211: New Term Defined: Domestic Support Obligation. Intended to Include all Support and Support Related Debts

To ensure that *all* debts relating to the support of a debtor's spouse, former spouse, family or child are given a similar treatment in bankruptcy, section 211 of the Reform Act provides a sweeping definition for the concept of a "domestic support obligation." This definition is intended to clarify the following:

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[2] See, e.g., *In re Platter*, 140 F.3d 676 (7th Cir. 1998); *County of Contra Costa* v. *Visness*, 57 F.3d 775 (9th Cir. 1995), *cert. denied* __U.S.__, 116 S.Ct. 828, 133 L.Ed.2d 770 (1996); *County of Santa Clara* v. *Ramirez*, 795 F.2d 1494 (9th Cir. 1986), *cert. denied*, 481 U.S. 1003, 107 S.Ct. 1624, 95 L.Ed.2d 198 (1987).

[3] *In re Stovall*, 721 F.2d 1133 (7th Cir. 1983); *In re Carlson*, 176 B.R. 890 (Bkrtcy.D.Minn. 1995); *In re Jones*, 94 B.R. 99 (Bkrtcy.N.D.Ohio 1988); *In re Walden*, 60 B.R. 641 (Bkrtcy.M.D.Fla. 1986); *In re McLean*, 59 B.R. 675 (Bkrtcy.E.D.Va. 1986); *State of Oregon* v. *Richards*, 45 B.R. 811 (D.Ore. 1984); *In re Mojica*, 30 B.R. 925 (Bkrtcy.E.D.N.Y. 1983); *In re Leach*, 15 B.R. 1005 (Bkrtcy.D.Conn. 1981).

[4] *In re Crouch*, 199 B.R. 690 (9th Cir.BAP 1996).

[5] *In re Saafir*, 192 B.R. 964 (Bkrtcy.D.Neb. 1996); *In re Erfourth*, 126 B.R. 736 (Bkrtcy.W.D.Mich. 1991).

[6] *In re Furlong*, 155 B.R. 517 (Bkrtcy.W.D.Mo. 1993).

[7] *In re Spinks*, 233 B.R. 820 (Bkrtcy.S.D.Ill. 1999).

1. The domestic support obligation includes interest on that obligation as provided under applicable nonbankruptcy law. Thus, if a State provides for prejudgment or postjudgment interest on support, such interest is included in the definition of a domestic support obligation.

2. To be nondischargeable support, the obligation must be *owed to* or *recoverable by* a "spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative[8]" or the debt must be owed to a governmental unit. As distinguished from former law as interpreted by the courts, the debt no longer need be owed to the person or entity filing the claim. It need only be recoverable by such entity. This definition is meant to preserve present statutory or decisional law affecting the dischargeability of debts in the nature of support owed to attorneys or other persons or entities providing assistance to the creditor spouse and children in a domestic proceeding.[9] Nor is there any remaining requirement that the debt be assigned to a government or recoverable under Title IV-D of the Social Security Act[10] for the debt to be excepted from discharge. The debt need only be owed to or recoverable by a governmental unit. Likewise, the debt does not become dischargeable simply because the support was ordered to be paid to the government or a nonparent. Support ordered to be paid to a legal guardian or responsible relative is also not dischargeable.

3. As under the former law, to be excepted from discharge the debt must be "in the nature of support." Unlike the former law, however, a debt based upon assistance provided by a governmental unit for the benefit of a spouse, former spouse or child of the debtor, is now specifically included as a debt in the nature of support. This classification applies whether or not the debt incurred by the debtor is specifically designated as support and whether or not the spouse, former spouse or child has a separate legal right to establish a support obligation.

4. Under former law the support debt had to made "in connection with a separation agreement, divorce decree, or other order of a court of record." Therefore, it was arguable that if the debt had not been reduced to an agreement, decree or order on the date a petition for relief was filed, it was not excepted from discharge. The new definition of a domestic support obligation specifies to the contrary that the debt may be established "or subject to establishment before or after an order for relief" to qualify as a nondischargeable debt.

5. Finally the definition of a domestic support obligation continues to exclude support which has been assigned to a *non*governmental entity, unless the assignment is merely

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[8] This term is intended to refer to the person who is a caretaker relative responsible for a child or children and who is eligible to receive payment of support for such child or children. See 45 C.F.R. §302.38.

[9] *See, e.g., In re Chang*, 163 F.3d 1138 (9th Cir.1998); *In re Hudson*, 107 F.3d 355, 357 (5th Cir. 1997); *In re Kline*, 65 F.3d 749 (8th Cir. 1995).

[10] 42 U.S.C. §§651 *et seq.*

made for the purpose of collecting the debt. This new definition codifies some existing case law.[11]

III. ALL SUPPORT DEBTS ARE TREATED SUBSTANTIALLY THE SAME

Having created this definition of a "domestic support obligation," the Reform Act uses it in twenty specific places. In so doing, the Act generally treats support related debts similarly, no matter how the debt arose or to whom the debt is owed.

A. Priority of Support Debts and Distribution of Support

Sec. 212: ***(1) All Domestic Support Obligations Given Priority 1***

(2) Payment of Claims for Domestic Support Obligation Debts Will Be Distributed As Required Under Nonbankruptcy Law

All domestic support obligation debts are given a first priority. Within that priority two categories of support debts are established. Support debts owed directly to support recipients, as of the date of the bankruptcy petition, are paid prior to debts owed or assigned to the government. Therefore all claims filed as priority 1 (A) would be paid by the trustee prior to claims filed as priority 1 (B).

When, however, such claims are filed by a governmental unit and that unit receives payments on the claim, the subsequent application and distribution of moneys are governed not by the claim as it existed on the petition date, but by nonbankruptcy law applicable to such governmental units. Thus, receipt of money claimed as a priority 1 (A) debt may be distributed by the government to reimburse itself for the payment of public assistance if the creditor assigns that debt to the government postpetition. Likewise, debts which are assigned to the government prepetition and claimed as priority 1 (B) debts will be distributed directly to the support obligee if the debt is no longer assigned as of the date the government received the funds.

Other changes in distribution may also occur. If the trustee pays a governmental entity on a claim in one month, and the debtor owes but has not paid a support order accruing in that month, the governmental unit may credit the payment to the current month's obligation, not to the claim. The governmental unit may also credit any payment received on the claim against newly accrued postpetition judgment interest, rather than against the principal portion of the claim. The purpose of these rules relating to governmental support claims is to allow the distribution of money received as support in the same manner it would be distributed if the debtor had not filed a bankruptcy petition.

B. Dischargeability of Domestic Debts

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[11] *In re Beverly*, 196 B.R. 128, 132-133; *In re Smith*, 180 B.R. 648 (D.Utah, 1995); *In re Reichardt*, 27 B.R. 751, 753 (Bkrtcy.W.D.Wash. 1983); *Matter of Begin*, 19 B.R. 759, 761.

Sec. 215: ***All "Domestic Support Obligations" Nondischargeable***

This Act now makes all domestic support obligations nondischargeable. The most significant effect of this change is that all debts owed to a governmental entity which are derived from payments by the government to meet needs of the debtor's family for support and maintenance are excepted from discharge. This change will nullify the holdings cited in footnotes 2, 4, 5, 6, and 7. By repealing §523(a)(18) and amending §523(a)(5), all "domestic support obligations" as broadly defined in new section 101(14A) of the Bankruptcy Code are excepted from discharge.

Section 215 also makes nondischargeable all non-support debts incurred in connection with a divorce or separation. Previously such debts may have been determined to be nondischargeable only if the support creditor brought a timely proceeding to determine the dischargeability of the debt and proved not only that the debtor had the ability to pay the debt but that discharging the debt would result in a benefit to the creditor which outweighed the detriment to the debtor. This provision gives debts resulting from the division of property the same protection from discharge as support debts.

C. Enforcement and Protection of Domestic Support Obligations

Sec. 216: ***(1) Exempt Assets Are Not Protected From Domestic Support Creditors***

(2) Application of Exempt Assets to Support Debts is a Matter of Federal Law

(3) No Judicial Liens Securing Payment of Any Domestic Support Obligation May be Avoided

Section 522(c)(1) of the Code, as amended by Section 216 of the Bankruptcy Reform Act, incorporates the new definition of a domestic support obligation into the existing provision which subjects otherwise exempt assets to debts for nondischargeable taxes and support obligations. This principle is expanded under the Bankruptcy Reform Act to preempt state law and specifically provide that under federal law such exempt property must be made available to satisfy a domestic support obligation, notwithstanding state law to the contrary. The purpose of this provision is to nullify the Fifth Circuit *en banc* holding in *Matter of Davis*, 170 F.3d 475 (5th Cir. 1999), and to reinstate the holding of the original Fifth Circuit panel.[12]

Section 522(f)(1) allows a debtor to avoid judicial liens on exempt property, but contains an exception for liens which secured unassigned child support. The Bankruptcy Reform Act extends this exception to domestic support obligations. Therefore, any judicial lien placed on

[12] *Matter of Davis*, 105 F.3d 1017 (5th Cir. 1999).

the debtor's property which secures a support related obligation, whether assigned or not, may not be avoided even though the lien impairs the exemption to which the debtor would otherwise have been entitled.

Sec. 217: No Payment of Any Domestic Support Obligation May be Recovered as a Preferential Transfer

Section 547(c)(7) previously barred the trustee for recovering, as a preferential transfer, *bona fide* payments of an *unassigned* support obligations. The Bankruptcy Reform Act extends this exception to all domestic support obligations, including those assigned to the government.

IV. THE AUTOMATIC STAY

Sec. 214: New Support Related Exceptions to the Automatic Stay

a. Exceptions to Collect Support Include All Domestic Support Obligations

b. Automatic Stay Inapplicable to Collection of Current Support and any Support Arrearage from Non-estate and Estate Property

c. Automatic Stay Inapplicable to License Revocation

c. Automatic Stay Inapplicable to Credit Reporting

d. Automatic Stay Inapplicable to the Tax Refund Intercept Program

e. Automatic Stay Inapplicable to Enforcement of Medical Support Obligations

The Bankruptcy Reform Act also adds additional exceptions to the automatic stay. Under §362(a) various activities of creditors are stayed once a bankruptcy petition has been filed. Under former law there were exceptions to the automatic stay which permitted the establishment of paternity, and the establishment or modification of a support order but they did not deal with a number of other domestic issues.[13] In addition, under former law the automatic stay did not apply to the collection of support so long as it was collected from property which was not property of the bankruptcy estate.[14] Since property of the estate included debtor's income in Chapter 12 and

[13] 11 U.S.C. §362(b)(2)(A).

[14] 11 U.S.C. §362(b)(2)(B).

13 cases,[15] at least until confirmation of the plan,[16] a support creditor had no way of enforcing payment of either on-going support or a prepetition support arrearage unless the obligor/debtor paid these debts voluntarily or the creditor obtained relief from the stay. These amendments deal with both issues. They include the following:

1. The existing exceptions are amended to refer to the new definition of a domestic support obligation. Additional language is added to clarify that certain other family-related matters such as custody, divorce, and domestic violence proceedings may continue to be pursued without obtaining relief from the automatic stay except to the extent a divorce proceeding seeks to deal with the division of estate property. Property division issues in a divorce are not intended to impinge on the exclusive jurisdiction of the bankruptcy court over estate assets.

2. Section 362(b)(2)(C) is added to provide for the withholding of income from property of the debtor or from *property of the estate* for the payment of a domestic support obligation. In this provision Congress has divested the bankruptcy court of exclusive jurisdiction over the bankruptcy estate to the extent a debtor's wages are estate property. Under prior law such withholding would have been allowed only if it were determined that the debtor's income was no longer property of the estate. This section specifically allows the use of estate property to pay support through the wage withholding process without any bankruptcy imposed limitation.[17] The purpose of this provision is to allow income withholding to be implemented or to continue after a Chapter 11, 12 or 13 petition is filed, just as it would if a Chapter 7 petition were filed.[18] The income withholding provisions were enacted to allow compliance with procedures mandated in the Child Support Enforcement Program, Social Security Act, Title IV-D.[19] Income withholding applies to the collection of on-going support and any support arrearage. It may be implemented by court order or through an administrative process.

3. Use of other support enforcement techniques are also excepted from the reach of the automatic stay. Under §362(b)(2)(D) the withholding, suspension, or restriction of drivers' licenses, professional and occupational licenses, and recreational licenses under state law as

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[15] 11 U.S.C. §§1207, 1306.

[16] 11 U.S.C. §§1227(b), 1327(b).

[17] Of course other laws may limit such collection such as state exemption laws and the Consumer Credit Protection Act, 15 U.S.C. §1673.

[18] Under current law in Chapter 7 and 11 cases, earnings and §541 property acquired postpetition are not property of the estate and may be seized to satisfy support arrears without violating the automatic stay, *In the Matter of Daugherty*, 117 B.R. 515, 517-518 (Bkrtcy.D.Neb. 1990). *See also*, *Matter of Hellums*, 772 F.2d 379 (7th Cir. 1985). While the Bankruptcy Reform Act now makes the postpetition individual earnings of Chapter 11 debtors property of the estate, this amendment will insure that they remain liable for enforcement of a domestic support obligation.

[19] See 42 U.S.C. §§666(a)(1), 666(a)(8), and 666(b).

provided in the Social Security Act[20] is not stayed. Nor under §362(b)(2)(E) is the reporting of overdue support to a consumer reporting agency as required by the Social Security Act.[21] Also excepted from the automatic stay under §362(b)(2)(F) is the interception of tax refunds as required by the Social Security Act.[22] Thus, refunds which are payable to the debtor by the State taxing authorities or the IRS, and even refunds which the debtor intends to include or includes in his or her bankruptcy estate, may be seized to satisfy support obligations as required or allowed under State and federal law without requiring relief from the automatic stay. Finally, under §362(b)(2)(G) the enforcement of medical support obligations as mandated by the Social Security Act[23] is not stayed.

V. CHECK POINTS TO ENSURE COMPLIANCE WITH SUPPORT ORDERS

Sec. 213: ***(1) Provides for the Conversion or Dismissal of the Petition of a Debtor Who Does Not Remain Current in the Payment of a Domestic Support Obligation***

(2) Automatic Denial of Confirmation of Plan of Debtor Who Does Not Remain Current in the Payment of Postpetition Support

(3) Automatic Denial of Discharge of Debtor Who Has Not Paid All Support Required to Be Paid During Bankruptcy

(4) Allows (But Does Not Require) Debtor to Include Payment of Postpetition Interest In Plan

Section 213 sets up four check points to ensure that debtors are complying with their domestic support obligations when they have filed a bankruptcy case under Chapters 11, 12, and 13.

1. A case can be converted or dismissed at any time if the debtor does not remain current in the payment of an on-going support obligation. Under former law the Code did not explicitly require such payments or mandate an early termination of a plan when a debtor was not in compliance with an on-going support order, although some courts used their discretion to dismiss such cases for "cause." The Act allows the court to convert or dismiss a Chapter 12 or 13

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[20] 42 U.S.C. §666(a)(16).

[21] 42 U.S.C. §666(a)(7).

[22] 42 U.S.C. §§664, 666(a)(3).

[23] See 42 U.S.C. §§666(a)(19).

plan for failure of the debtor to pay postpetition on-going support.[24]

2. To be confirmed a plan must provide for payment of all past due priority claims for domestic support obligations.[25] The Code does, however, provide two exceptions. It allows a creditor the option of accepting less than full payment under the plan.[26] It also allows a debtor to "cram down" a less than full payment plan for priority support debts which are assigned to a governmental entity, so long as the plan provides for payment of all disposable income of the debtor for the maximum five year period allowed for a plan in Chapters 12 and 13.[27] However, since these debts will not be discharged in any event, the debtor will be given a substantial incentive to propose and complete such a plan.

3. A plan under Chapters 11, 12, and 13 may not be confirmed unless the debtor has remained current in the payment of all support first becoming due postpetition.[28] Nor can a debtor in a Chapter 12 or 13 case obtain a discharge unless all support becoming due postpetition has been paid.[29] These provisions are designed to be self-executing, at least to the extent they do not require affirmative action on the part of a support creditor to implement them. Payment of domestic support obligation arrears, in order to receive a discharge, is required only to the extent "provided for by the plan." Thus, agreements made at the time of confirmation to accept less than full payment or the use of "cram down" rights possessed by the debtor may allow the debtor to receive a discharge without full payment of all prepetition domestic support obligations. Of course, completion of such a plan would not discharge any remaining domestic support obligations, but would allow the debtor to be relieved from other debts covered by the general discharge under the relevant chapter.

4. The Act allows, but does not require, the debtor to include in a plan the payment of postpetition interest on a nondischargeable debt if the debtor is able to do so after paying other debts. This provision is a departure from former law which did not allow a claim for interest, unless the claim was secured, even though interest continued to accrue on

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[24] 11 U.S.C. §1208(c)(10) added by Sec. 213 (2)(C) of the Act; 11 U.S.C. §1307(c)(11) added by Sec. 213(7)(C) of the Act.

[25] Full payment of priority claims as a condition of confirmation of Chapter 12 or 13 plans existed under former law. See 11 U.S.C. §§1222(a)(2), 1322(a)(2).

[26] 11 U.S.C. §§1222(a)(2), 1322(a)(2).

[27] 11 U.S.C. §1222(a)(4) added by Sec. 213(3)C) of the Act; 11 U.S.C. §1322(a)(4) added by Sec. 213(8)(C) of the Act.

[28] 11 U.S.C. §1129(a)(4) added by Sec. 213(1) of the Act; 11 U.S.C. §1225(a)(7) added by Sec. 213(5)(C) of the Act; 11 U.S.C. §1325(a)(7) added by Sec. 213(10)(C) of the Act.

[29] 11 U.S.C. §1228(a) amended by Sec. 213(6) of the Act; 11 U.S.C. §1328(a) amended by Sec. 213(11) of the Act.

nondischargeable debts.[30] As a result, even if the debtor provided for full payment of the prepetition support debt, this debtor would be left at the end of the plan with a remaining debt for interest. Accordingly, while a debtor will often not have sufficient income to make postpetition interest payments, the debtor may wish, if feasible, to make such payments in order to obtain a fresh start at the completion of the plan.

[30] 11 U.S.C. §502(b)(5).

Mr. CANNON. Without objection, all Members may place their statements in the record at this point. Any objection? If not, so ordered.

Without objection, the Chair will be authorized to recess the Subcommittee today at any point. Hearing none, so ordered.

On unanimous consent, I request that Members have 5 legislative days to submit written statements for inclusion in today's hearing record. Hearing no objection, so ordered.

I am pleased to now introduce the witnesses for today's hearing. Our first witness is Mr. Lawrence Friedman, who is the Director of the Executive Office for the United States Trustees in the Department of Justice in Washington, D.C. Prior to his appointment as Director, which I know it occurred 1 year ago today, Mr. Friedman was a partner in the Southfield, Michigan, law firm of Friedman and Kohut, where his practice included consumer business bankruptcy matters as well as commercial litigation. In his capacity as a Chapter 7 trustee, Mr. Friedman administered more than 10,000 bankruptcy cases. Mr. Friedman received his undergraduate degree from Hillsdale College in Hillsdale, Michigan, and his law degree from Thomas M. Cooley Law School in Lansing, Michigan.

Our next witness, Ms. Lucile Beckwith, is president and chief executive officer of the Palmetto Trust Federal Credit Union located in Columbia, South Carolina. Ms. Beckwith has served in that capacity since 1980. Today Ms. Beckwith appears on behalf of the Credit Union National Association, which represents more than 90 percent of the 10,500 Federal and State credit unions across the Nation. Palmetto Trust, which is a member of this organization, is a $21.3 million federally chartered credit union with approximately 3,700 members.

Joining Ms. Beckwith will be Judith Greenstone Miller. Ms. Miller appears today on behalf of the Commercial Law League of America. Founded in 1895, the Commercial Law League is the Nation's oldest organization, with nearly 5,000 professionals engaged in collections, creditors' rights and bankruptcy matters. Ms. Miller is a member of the law firm of Raymond & Prokop, located in Southfield, Michigan. Her practice focuses on bankruptcy and insolvency matters, creditors' rights and commercial litigation. She represents secured and unsecured creditors, debtors, and bankruptcy trustees in Chapter 11 organizations. Ms. Miller received her law degree cum laude from Wayne State University School of Law in 1978. Prior to that, she attended the University of Michigan where she obtained her undergraduate degree, also cum laude, in 1975.

George Wallace, who is a counsel to the law firm of Eckert Seamans Cherin & Mellot, is our final witness. Mr. Wallace speaks today on behalf of the Coalition of Responsible Bankruptcy Laws, which represents a broad spectrum of consumer creditors, including retailers, banks, credit unions, savings institutions, mortgage companies, sales finance companies and financial service providers. His practice includes representation of debtors and creditors. He has also specialized in consumer mortgage credit. Beginning the practice—or before beginning the practice of law, Mr. Wallace was a professor of law for 15 years. He taught at Tulane University, the University of Iowa College of Law, University of Virginia, Stanford and Rutgers. He served as a faculty adviser to a low-income legal clinic that he started in Iowa. He also served as trustee and debtors' counsel. Mr. Wallace received his law degree from the University of Virginia Law School, where he was a member of the Order of the Coif and the Law Review. He received his bachelor of arts degree from Yale University cum laude.

I ask that each witness present his or her oral remarks within the 5-minute period, as we talked about earlier. I will tap the gavel as soon as the red light goes on, and we will do that without distinction, but at that point if you could wrap up in a reasonable amount of time, we would appreciate that. Your written statements will be included in the hearing record. So feel free to summarize or highlight the salient points of your testimony.

After the witnesses have presented their remarks, the Subcommittee Members in order that they arrive will be permitted to ask questions of the witness subject to the 5-minute limitation. There may also be a second round of questioning if the panel desires—or if the Committee desires.

Mr. Friedman, would you now proceed with your testimony.

STATEMENT OF LAWRENCE A. FRIEDMAN, DIRECTOR, EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES, UNITED STATES DEPARTMENT OF JUSTICE

Mr. FRIEDMAN. Thank you, Mr. Chairman and Members of the Subcommittee. I appreciate the opportunity to appear before the Subcommittee to discuss the United States Trustees Program' ongoing work to combat fraud and abuse under current bankruptcy law, as well as the potential enhancement of this work through omnibus bankruptcy reform legislation. I submit my written testimony for the record, and will take a few minutes now to focus on the bankruptcy reform legislation.

We believe the provisions proposed in H.R. 975, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2003," would provide important new statutory tools to assist the United States Trustee Program in identifying and civilly prosecuting misconduct by debtors and others who misuse the bankruptcy system. The United States Trustee Program is the component of the Department of Justice with the responsibility for the oversight of bankruptcy trustees and cases. Our mission is to enhance the efficiency and the integrity of the bankruptcy system. The fraud and abuse provisions contained in H.R. 975 would increase the effectiveness of the program's National Civil Enforcement Initiative and other efforts described in my written testimony. In fact, we have already made significant progress in preparing to implement such legislation. As we reported in testimony presented to this Committee during the last Congress, we convened working groups to develop implementation plans for each of the major new areas of responsibility that would be imposed upon the program under bankruptcy reform legislation. Of course, implementation plans will not be completed until after legislation is enacted.

The United States Trustee Program's current enforcement efforts would be aided in particular by the following provisions contained in H.R. 975. Section 102 amends the substantial abuse provisions in current law. In addition to permitting dismissal of cases under current standards, this section codifies a specific procedure and monetary standard for reviewing individuals in Chapter 7 who have primarily consumer debt, and it provides a more objective basis for determining which cases will be presumed abusive. This provision would provide much needed consistency in the application of abuse standards in all districts in the United States.

Section 603 directs the Attorney General to conduct both random and targeted audits of Chapter 7 and Chapter 13 debtors to ensure against material misstatements. The debtor's discharge is also conditioned on cooperating and making information available to the auditors. This provision would provide a mandate for an intensive and ongoing audit program to greatly enhance current methods for the detection of fraud and abuse.

Section 105 and 106 create new areas of responsibility for the United States Trustee Program with regard to debtor education and credit counseling. The program must approve and maintain a list of credit counselors who would be able to provide financial counseling to all individuals before they are eligible to file for bankruptcy. The program would also be responsible for approving and maintaining a list of those who could provide personal financial management courses, and debtors would have to complete such a course after they filed bankruptcy in order to receive a discharge. This provision would address the widespread problem of financial illiteracy. These provision would also help ensure that debtors make informed choices before seeking bankruptcy relief and get the greatest benefit from the fresh start they are given by the discharge of debt.

Under section 221, bankruptcy petition preparers will be required to give their customers a prescribed notice that they are not attorneys and cannot give legal advice. Provisions for fines and injunctions are strengthened, and the Judicial Conference is given authority to set maximum allowable bankruptcy petition preparer fees. This provision increases the accountability of bankruptcy petition preparers whose actions can have a devastating effect on debtors who seek bankruptcy protection to save their residences or for other legitimate purposes.

In summary, we commend the sponsors of H.R. 975 and the Members of this Subcommittee for recognizing the serious and far-reaching nature of bankruptcy fraud and abuse. The United States Trustee Program is committed to combatting this problem with the statutory tools at our disposal. In addition, we look forward to implementing the fraud and abuse provisions of H.R. 975 if it is enacted. These provisions will assist the program in carrying out its National Civil Enforcement Initiative and improving the efficiency and integrity of the bankruptcy system.

Mr. Chairman, that concludes my remarks. I will be happy to answer questions from you and the Members of your Subcommittee.

Mr. CANNON. Thank you, Mr. Friedman.

[The prepared statement of Mr. Friedman follows:]

PREPARED STATEMENT OF LAWRENCE A. FRIEDMAN

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear before the Subcommittee on behalf of the Department of Justice to discuss the United States Trustee Program's ongoing work to combat fraud and abuse under current bankruptcy law, as well as the potential enhancement of this work through omnibus bankruptcy reform legislation.

The Department believes that provisions proposed in H.R. 975, which was introduced on February 27th, would provide important new statutory tools to assist the United States Trustee Program in identifying and civilly prosecuting misconduct by debtors and others who misuse the bankruptcy system.

The United States Trustee Program (USTP or Program) is the component of the Department of Justice with responsibility for the oversight of bankruptcy trustees and cases. Our mission is to enhance the efficiency and the integrity of the bankruptcy system. In October 2001, the USTP commenced a National Civil Enforcement Initiative to address bankruptcy fraud and abuse. The Program undertook this Initiative for several reasons, including the following:

> The bankruptcy caseload is the largest in the federal court system. Disrespect for the bankruptcy system breeds disrespect for the entire judicial system. As the bankruptcy caseload continues to climb, more and more Americans are coming into contact with the nation's bankruptcy system. In addition to the 1.5 million individuals and businesses that sought debt relief in Fiscal Year 2002, millions more were affected, including creditors, many of them small businesses; employees; retirees; and families. It is critical that this system of justice be respected as one in which the law is strictly and fairly enforced.
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> The integrity of the bankruptcy system relies upon complete and accurate disclosure by debtors and other participants in the system. The bankruptcy system largely depends upon self-reporting by debtors of their assets, liabilities, and other financial affairs. There is a consensus among bankruptcy professionals, including judges and practicing lawyers, that documents filed by debtors, petition preparers, and even attorneys who represent parties in a bankruptcy case too often are inaccurate and ignore the requirements of the Bankruptcy Code and Rules.
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> The monetary stakes in the bankruptcy system are substantial. Studies show wide disparity in potential criminal and non-criminal abuse of the bankruptcy system. But with more than 1.5 million new cases filed each year, more than $5 billion disbursed annually by private trustees in chapter 7, 12, and 13 cases, and hundreds of billions of dollars in corporate assets and liabilities subject to chapter 11 protection, potential recoveries are staggering.

The National Civil Enforcement Initiative was designed for two major purposes:

(1) To Address Debtor Misconduct: Under this prong of the Initiative, the Program uncovers such improper conduct as inaccurate financial disclosure, misuse of social security numbers, concealment of assets, and "substantial abuse" by those who seek discharge of debts despite an ability to repay. The primary civil remedies sought by Program attorneys are dismissal under 11 U.S.C. §§ 707(a) and (b) and denial of discharge under § 727.

(2) To Ensure Consumer Protection: The Program also seeks to protect debtors and creditors who are victimized by those who mislead or misinform debtors, file bankruptcy petitions without a debtor's knowledge, make false representations in a bankruptcy case, or commit other wrongful acts in connection with a bankruptcy filing. Primary targets are unscrupulous bankruptcy petition preparers and attorneys. The primary remedies sought are fines and injunctions under 11 U.S.C. § 110 and disgorgement of fees under § 329.

In addition to civil remedies taken by the Program, actions that constitute criminal misconduct are referred to the FBI and the United States Attorney for prosecution.

As we have devoted more resources to civil enforcement, we have identified patterns of conduct that appear widespread and deserving of continued intensive pursuit. Some examples follow.

> Substantial Abuse: As our offices more carefully screen chapter 7 petitions, we have ferreted out a high number of cases which, under almost any court standard, show substantial abuse by debtors who fail to disclose their true financial condition and seek to discharge debt despite an ability to repay all or part of that debt.

- On March 5, 2002, the bankruptcy court for the Central District of California granted the U.S. Trustee's motion to dismiss the case of a debtor for substantial abuse under 11 U.S.C. § 707(b). The U.S. Trustee argued that the debtor's monthly mortgage and utility payments in excess of $6,700 were patently unreasonable. The debtor, who had filed for bankruptcy on the eve of foreclosure on her home which she valued at $900,000, had also filed for chapter 13 relief two times since 1997, in each case to prevent foreclosure. In her most recent filing, the debtor did not list her prior filings or other material information including rental income and a $93,000 second trust deed on her home. The bankruptcy court agreed that the debtor's excessive housing costs and the material omissions in her filing supported a finding of substantial abuse.

In Fiscal Year 2002, the Program successfully pursued more than 5,000 debtors under § 707(b) and prevented the chapter 7 discharge of almost $60 million of debt.

Concealment of Assets: Debtors who conceal or transfer assets, destroy or fail to provide financial records, make false statements, or commit other wrongful acts may be subject to denial of their discharge.

- On November 1, 2001, a debtor was denied a chapter 7 discharge following an all-day trial before the bankruptcy court for the District of Nevada. The debtor filed his petition seeking to discharge almost $650,000 in debt, without disclosing a revocable trust into which he transferred his residence, personal property, and summer home. Upon its discovery, the debtor disclosed the transfer in the fourth amendment to his schedules claiming he failed to disclose it upon the advice of counsel. The court held that the debtor's desire to retain the property, together with other facts established at trial, provided the requisite intent to deny the discharge.

In Fiscal Year 2002, more than 800 debtors were denied a discharge of more than $40 million of debt on the grounds of serious misconduct under § 727.

Credit Card Bust-Outs: Recent cases have been uncovered in which debtors obtained credit cards despite little or no income, incurred huge debts, paid those debts with worthless checks, and incurred debt up to the credit limit again before the checks bounced.

- On October 4, 2002, in Chicago, Illinois, a debtor who pleaded guilty to bankruptcy fraud and conspiracy charges was sentenced to a twelve month prison term and supervised release of three years, was ordered to pay restitution in the amount of $337,255, and agreed to waive his bankruptcy discharge. In his bankruptcy case, the debtor sought to discharge approximately $366,955 in debts; falsely represented that he had $270,000 in cash gambling losses during 2000–2001; and declared falsely under oath that he had no interest in any real property. The United States Trustee identified the debtor's credit card bust-out scheme as part of its civil enforcement efforts to review all chapter 7 bankruptcy cases filed in the Northern District of Illinois for fraud and abuse. Several members of the Chicago U.S. Trustee's office assisted law enforcement with the investigation.

Identity Theft: The Program now requires all debtors to show proof of identity at the first meeting of creditors, which is required to be held in all bankruptcy cases. In many cases of identity theft, a person assumes someone else's identity before filing a bankruptcy case and obtains credit, along with goods and services, using that false identity. Often these crimes are not uncovered until years later when the victim tries to buy a home or obtain credit for some other purpose.

- On January 28, 2002, a debtor pleaded guilty in the Northern District of Georgia to seven counts of a nine count indictment charging him with wire fraud, mail fraud, the use of a false social security number, identity theft, and bankruptcy fraud. The debtor worked for a mortgage broker and originated and processed his own loans. He used the name, social security number, and credit history of another individual to obtain two loans to purchase real property, inducing a lender to wire transfer more than $428,000 to the settlement agent. When the debtor defaulted on the loans, he filed for bankruptcy to stay the foreclosure sale. The Atlanta office of the U.S. Trustee referred the matter to the U.S. Attorney.

In Fiscal Year 2002, the Program identified 8,000 debtor identification problems and caused debtors to correct more than 6,000 petitions. Many of these cases involved typographical errors in social security numbers that were corrected to prevent future injury to unsuspecting, potential victims. Other cases involved intentional fraud.

Bankruptcy Petition Preparers: Some of the most egregious abuses in the bankruptcy system are perpetrated by those who prey upon debtors. Most people who file bankruptcy are in dire financial straits and are ill-equipped to scrutinize offers of assistance. Many of these debtors face imminent foreclosure on their homes. Non-attorney bankruptcy petition preparers solicit clients from publicly available lists of those facing foreclosure.

Petition preparers sometimes charge exorbitant rates, engage in the unauthorized practice of law, file bankruptcy cases without the knowledge of debtors, use the bankruptcy process to further fraudulent schemes such as mortgage fraud, or otherwise violate the law. The victims of mortgage fraud often are both debtors and creditors.

- In two cases prosecuted both civilly and criminally in the Washington, DC area, petition preparers defrauded both debtors and mortgage lenders by filing bankruptcy cases in violation of § 110 in the names of debtors who paid significant fees to the defendants in return for refinancing or real estate services that were never provided. In one case, the defendant, while on pre-trial release, also took over properties facing foreclosure, filed bankruptcy petitions to delay foreclosure, and then rented the properties to innocent families with a purported option to buy. The renters uncovered the scheme when the mortgage lender finally was able to restart foreclosure proceedings. In one case, the victimized family of eight faced eviction shortly before Christmas.

In Fiscal Year 2002, the Program successfully took action under § 110 against petition preparers in more than 1,500 cases.

In addition to the invigorated litigation efforts described above, the Program has taken other significant actions to uncover fraud and abuse. Last summer, the Program conducted audits of a small sample of chapter 7 cases in a pilot program we hope to expand in Fiscal Year 2003. The results of the pilot are being reviewed now to determine the best methodology to employ a more widespread audit effort. The results of the audit will help determine the scope of fraud and abuse in the bankruptcy system, as well as identify specific cases for civil and criminal enforcement actions.

Because public outreach is also important, the Program is developing an informational video that will be distributed and made widely available for debtors and attorneys to view prior to filing bankruptcy. The video will make debtors aware of the basic bankruptcy process and the need to be forthcoming and accurate in their bankruptcy filings.

Two other USTP activities will further strengthen our civil enforcement efforts. First, the Program will continue to provide training on the detection and litigation of abuses in the bankruptcy system for its attorneys and accountants. Similar training is also being developed for the private trustees. Second, the Program has designed a new data collection system to measure our success in civil enforcement and has begun to automate data collection to reduce the reporting burden on field staff and to increase the accuracy of the information.

The results of our first year after implementing the National Civil Enforcement Initiative are dramatic. During Fiscal Year 2002, field offices reported that they took more than 50,000 civil enforcement and related actions (including cases resolved without resort to litigation) that yielded approximately $160 million in debts not discharged and potentially available for distribution to creditors. This impressive data demonstrates the scope of the problem, the skill and effectiveness of our attorneys and other staff in the field, and the need to continue our focused attack on bankruptcy fraud and abuse.

The fraud and abuse provisions contained in H.R. 975 would increase the effectiveness of the Program's National Civil Enforcement Initiative. In fact, we already have made significant progress in preparing to implement that legislation. As we reported in testimony presented to this Subcommittee during the last Congress, we convened working groups to develop implementation plans for each of the major new areas of responsibility that would be imposed upon the Program under bankruptcy reform legislation. However, these plans would require modification, based upon the precise terms of the new legislation introduced in this Congress.

The USTP's current enforcement efforts would be aided in particular by the following provisions contained in H.R. 975:

Means Testing: Section 102 amends the substantial abuse provisions in current law. In addition to permitting dismissal of cases under current standards, this codifies a specific procedure and monetary standard for reviewing individuals in chapter 7 who have primarily consumer debt and provides a more objective basis for determining which cases will be presumed abusive. This provision would provide much needed consistency in the application of abuse standards in all districts.

Debtor Audits: Section 603 directs the Attorney General to conduct both random and targeted audits of chapter 7 and chapter 13 debtors to ensure against material misstatements. The debtor's discharge is also conditioned on cooperating with, and making information available to, the auditors. This provision would provide a mandate for an intensive and on-going audit program to greatly enhance current methods for the detection of fraud and abuse.

Debtor Education and Credit Counseling: Sections 105 and 106 create new areas of responsibility for the USTP. The Program must approve and maintain a list of credit counselors who would be able to provide financial counseling to all individuals before they are eligible to file bankruptcy. The Program would also be responsible for approving and maintaining a list of those who could provide personal financial management courses, and debtors would have to complete such a course after they file bankruptcy in order to receive a discharge. This provision would address the widespread problem of financial illiteracy. These provisions also would help ensure that debtors make informed choices before seeking bankruptcy relief and then obtain the necessary knowledge to avoid future financial catastrophe.

Bankruptcy Petition Preparers: Under Section 221, bankruptcy petition preparers will be required to give their customers a prescribed notice that they are not attorneys and cannot give legal advice. Provisions for fines and injunctions are strengthened, and the Judicial Conference is given authority to set a maximum allowable bankruptcy petition preparer fee. This provision increases the accountability of bankruptcy petition preparers whose actions can have a devastating effect on debtors who seek bankruptcy protection to save their residences or for other legitimate purposes.

In summary, the Department of Justice commends this Subcommittee for recognizing the serious and far-reaching nature of bankruptcy fraud and abuse. The USTP is committed to combating this problem with the statutory tools at our disposal. In addition, we look forward to implementing any new provision of bankruptcy law that the Congress may enact in the future. The fraud and abuse provisions contained in H.R. 975 would assist the Program in carrying out its National Civil Enforcement Initiative and improving the efficiency and integrity of the bankruptcy system.

Mr. Chairman, that completes my prepared remarks. I would be happy to answer questions from the Subcommittee at this time.

Mr. CANNON. The record should reflect that the gentleman from Ohio Mr. Chabot has joined us.

And, Ms. Beckwith, if you would like to proceed, we do appreciate that now.

STATEMENT OF LUCILE P. BECKWITH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, PALMETTO TRUST FEDERAL CREDIT UNION, COLUMBIA, SOUTH CAROLINA, ON BEHALF OF CREDIT UNION NATIONAL ASSOCIATION, INC.

Ms. BECKWITH. Good afternoon, Chairman Cannon and Members of the Subcommittee. I am Lucile Beckwith, president and CEO of the 21 million Palmetto Trust Federal Credit Union in Columbia, South Carolina. I appreciate the opportunity to be here to tell you about our concerns with bankruptcies and how they are impacting credit unions. I am speaking on behalf of the Credit Union National Association, CUNA, which represents over 90 percent of the 10,500 State and Federal credit unions nationwide.

Credit unions have consistently had three top priorities for bankruptcy reform legislation, a needs-based formula, mandatory financial education and maintaining the ability of credit union members to voluntarily reaffirm their debts. H.R. 975 does a good job of balancing these issues. With bankruptcy filings in 2002 exceeding 1.5 million, which is another new record, we strongly urge the 108th Congress to pass this compromise bill as soon as possible.

Credit unions have become quite concerned about bankruptcies in the last few years. Data from credit union call reports to the National Credit Union Administration suggest that roughly 256,000 credit union member borrowers filed in 2002. In addition, CUNA estimates that nearly 46 percent of all credit union losses in 2002 were bankruptcy-related. Those lawsuits totaled approximately $775 million.

Concerns about the rising tide of bankruptcy filings and the ever-increasing number of abusive filings are shared across the country. A January 2003 nationwide survey found that 64 percent of the public feels strongly that it should be made more difficult to declare bankruptcy. Armed with this knowledge, I assure you that Palmetto Trust is a careful lender. We cannot afford to do otherwise. We do a good job of scrutinizing loan applications and carefully determining that the applicant is credit-worthy before extending credit.

Unfortunately, even the most rigorous screening process cannot prevent all abusive bankruptcy filings. I would like to share an example from my written statement with the Subcommittee that clearly demonstrates how people abuse the system.

Take, for example, two members of my credit union. They were a couple with a six-figure income, each of which qualified for a $10,000 VISA card. At the same time, they were applying for credit cards at other places, openly gaming the system. During 1 month, they maximized all these credit cards with cash advances. They never made a payment on any of them, waited the required time, and then filed for a Chapter 7 bankruptcy. An appeal to the court for loading up was denied. Our small credit union lost $20,000. What did they do with the cash? Their daughter had a very large, beautiful and expensive wedding in Hawaii, a long way from South Carolina.

Credit unions clearly recognize the value of financial counseling for their members. According to a recent CUNA bankruptcy survey, 70 percent of credit unions counsel financially troubled members at the credit union or refer members to an outside financial counseling organization. That is why CUNA strongly supports the provisions in H.R. 975 that establish the principle that people need information and assistance to understand what bankruptcy means and how to avoid financial problems.

Because we are not-for-profit financial cooperatives, losses to the credit union have a direct impact on the entire membership due to a potential loss—potential increase to loan rates or a decrease in interest on savings accounts. Credit unions strongly believe that reaffirmations are a benefit both to the credit union which does not suffer a loss and to the member debtor, who, by reaffirming with the credit union, continues to have access to financial services and to reasonably priced credit.

Credit unions are very anxious to see Congress enact meaningful bankruptcy reform and believe that needs-based bankruptcy presents the best opportunity to achieve this important public policy goal. Credit unions believe that consumers who have the ability to repay all or part of their debts should be required to file a Chapter 13 rather than have all their debt erased in Chapter 7. Therefore, CUNA supports the needs-based provision that is contained in H.R. 975.

Mr. Chairman, all of this adds up to a bill that would create a fair and more realist Bankruptcy Code. Credit union members, because they own their institutions, feel the affects of abusive bankruptcies directly, and while no one is arguing that the bankruptcy legislation will completely eliminate abuses, no one should argue that the bill isn't necessary because it isn't perfect. It is our hope that this important legislation finally becomes law, that judges carefully follow the new law so that they make a more realistic view of people's capacity to repay their debts, and perhaps most importantly, a renewed sense of individual accountability becomes apparent.

Thank you, and I will be glad to answer any questions.

Mr. CANNON. Thank you, Ms. Beckwith.

[The prepared statement of Ms. Beckwith follows:]

PREPARED STATEMENT OF LUCILE P. BECKWITH

LEGISLATIVE ISSUES - BANKRUPTCY

Bankruptcy Abuse Reform

March 4, 2003

Lucile P. Beckwith Testimony before the House Judiciary Subcommittee on Commercial and Administrative Law

WRITTEN TESTIMONY OF LUCILE P. BECKWITH PRESIDENT/CEO, PALMETTO TRUST FEDERAL CREDIT UNION ON BEHALF OF CREDIT UNION NATIONAL ASSOCIATION (CUNA) BEFORE THE HOUSE JUDICIARY SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW MARCH 4, 2003

Good afternoon, Chairman Cannon and members of the Subcommittee. I am Lucile Beckwith, president and CEO of Palmetto Trust Federal Credit Union in Columbia, South Carolina and I appreciate the opportunity to be here to tell you about our concerns with bankruptcies and how they are impacting credit unions -- and my credit union in particular. I am speaking on behalf of the Credit Union National Association (CUNA), which represents over 90 percent of the 10,500 state and federal credit unions nationwide.

We are very pleased that the Subcommittee is holding today's hearing on H.R. 975, "The Bankruptcy Abuse Prevention and Consumer Protection Act of 2003." We thank Chairman Sensenbrenner and each of the bill cosponsors, including you, Mr. Chairman, for their leadership in reintroducing this important legislation.

Credit unions have consistently had three top priorities for bankruptcy reform legislation: a needs based formula, mandatory financial education, and maintaining the ability of credit union members to voluntarily reaffirm their debts. This bill, while a product of compromise, does a good job of balancing these issues. With bankruptcy filings in 2002 exceeding 1.5 million, which is another new record, we strongly urge the 108th Congress to pass this compromise bill as soon as possible.

Palmetto Trust is a $21.3 million federally chartered, federally insured credit union. Our field of membership includes Federal employees and several small select employee groups, including the Presbyterian Retirement Home and employees of a landscaping company and a mortgage broker firm. Palmetto Trust currently has 3,724 members, who have taken out $14.9 million in loans.

Credit unions are quite concerned about bankruptcies in the last few years because they have seen similar trends in the number of credit union members who file. Data from credit union call reports to the National Credit Union Administration (NCUA) suggest that roughly 256,000 credit union member-borrowers filed in 2002. This figure corresponds with the ever-increasing filings witnessed across the nation among all filers. In addition, CUNA estimates that nearly 46 percent of all credit union losses in 2002 were bankruptcy-related, and those losses totaled approximately $775 million.

In South Carolina, there was a 14.2 percent increase in the total number of credit union borrower bankruptcies in 2002. This translates to a total of 2,820 filings, accounting for roughly $11.6 million in losses due to bankruptcies.

Survey Research

Concerns about the rising tide of bankruptcy filings and the ever-increasing number of abusive filings are shared across the country. A November 2002 nationwide voter survey conducted by the Penn, Schoen firm found that 68 percent of voters agreed that it is "too easy" to declare bankruptcy, while another 61 percent said that they support tightening the bankruptcy laws. This tracks very closely with a January 2003 survey conducted for CUNA by the firm of Voter/Consumer Research, which found that 64 percent of the public feels strongly that it should be made more difficult to declare bankruptcy. And within the credit union movement, a 2003 survey found that 68 percent of credit union CEOs and volunteer Board members believe that bankruptcy abuse reform would provide the greatest legislative benefit to their credit union of all the issues under consideration. This is an increase of 17 percent from the previous year.

At Palmetto Trust Federal Credit Union, although we are a small credit union, bankruptcy filings and losses have shown a steady increase since 1997. In 1997 we had 5 members who filed for bankruptcy. Filings peaked in 1998 at 12. And while there were only 9 filings in 2002, they involved significantly higher balances than filings for previous years. Filings have been fairly evenly split between chapter 7's and 13's. Charge offs due to bankruptcy filings have accounted for approximately 40 percent of all charge offs during this time period.

Lending Criteria

Palmetto Trust is a careful lender. We cannot afford to be otherwise. We do a good job with scrutinizing loan applications and carefully determining that the applicant is creditworthy before extending credit. We examine credit reports, verify income, and see that a reasonable debt-to-income ratio is maintained by the borrower. We even look at the applicant's disposable income to determine that the applicant can make the payments. We routinely monitor our credit cards and do not make across-the-board increases to the credit limit.

If a member is experiencing financial problems and mentions bankruptcy to us, our loan officers inform the member of the downside to such an action--damaged credit, loss of services--and let the member know that the credit union is there to help them through the financial difficulty. We attend all 341 hearings, where creditors are permitted to question the debtor, and encourage reaffirmations by offering debtor-friendly terms.

In a further effort to understand and control this problem, we instituted in 1998 a new policy after profiling our bankruptcy charge offs and determined that most of them had more than the average in personal (unsecured) debt. So, we added a 40 percent of personal debt balances/annual gross income ratio. We really believe that this has helped us to avoid even more bankruptcy filings than we have already incurred. The number of loan applications we receive where the "bankruptcy ratio" is between 50 percent and 90 percent is surprising. And, yes, we have had a few where the ratio was over 100 percent! Our problem comes in cases like the one below where we granted the credit card when the member was within reason with credit limits:

Example of a 71- year old retired person			
	Date Opened	Limit	Balance
Bank Card	05/90	$5,500	$4,333
Credit Union Card	02/93	$4,800	$4,618
Bank Card	01/94	$10,100	$7,629
Credit Card	06/97	$3,000	$2,908
Credit Card	06/97	$4,000	$2,799
Bank card	07/97	$4,000	$3,605
Bank card	05/99	$4,679	$3,653
Bank card	08/99	$5,200	$3,772
Bank card	06/00	$2,000	$1,904
Bank Card	11/00	$ 433	$ 411
Credit Card	06/02	$1,000	$ 462
	Totals:	$44,712	$36,094

What I don't understand is why any credit grantor would continue granting unsecured debt to someone who can't pay them back. If a credit grantor is consolidating existing debts at a lower interest rate and can prove they paid off debts that is one thing—but to just extend more credit, as in this case, was unconscionable.

Examples of Abusive Filings

And there are other examples that clearly demonstrate how people abuse the system. Take, for example, two members of my credit union. They were a couple with a six-figure income, each of which qualified for $10,000 VISA cards (at the same time they were applying for other credit cards), openly gaming the system. During one month they maximized all these credit cards with cash advances. They never made a payment on any of them, waited the required time, and then filed for a Chapter 7 bankruptcy. An appeal to the court for "loading up" was denied. Our small credit union lost $20,000. What did they do with the cash? Their daughter had a very large, beautiful and expensive wedding in Hawaii—a long way from South Carolina.

Here's another example. A member had applied to increase their VISA card limit to $10,000 in April 1995 to consolidate most of his credit cards.

On the application, the member wrote, "I want to consolidate as many of these accounts as possible and have one or two bills per month. I plan to also close these accounts." The member had six accounts with total balances of $19,599. When the member filed bankruptcy in March 1999, just four years later, there were 13 credit accounts with unsecured balances of $59,392. The member filed a Chapter 13 and paid ten cents on the dollar to unsecured creditors. The member's annual income in was $43,363, which is well above the average for South Carolina. The member was still employed at the same agency when the bankruptcy was filed.

More recently is the example of a bankruptcy we received in May 2001. The member applied for a $2,500 advance from an open-end loan for home improvements in March 1999, bringing the loan balance to $3,994. At this time, the member's gross annual income was $82,272. The member had unsecured balances $31,545, accounting for 38 percent of his annual income. When the member filed a Chapter 7 in May 2001, the member owed $50,862 in unsecured debt. The member was not delinquent when the bankruptcy was filed, and the reason for the filing is unknown.

Even though not from my credit union, my favorite example is of the man who declared a Chapter 7 bankruptcy, leaving a Minnesota credit union with a $30,000 loss, then wrote an article back to his hometown newspaper. In the article, which pictured him in front of his new powerboat, the filer extolled the virtues of his retirement, recounting his multiple golf club memberships and fishing adventures!

Stigma

There are undoubtedly many reasons why people file abusive bankruptcies, but most certainly chief among them is that there is no longer the stigma that used to be attached to living up to one's personal financial obligations. Although measuring stigma is no easy task, a study conducted by the Cato Institute detailed several revealing glimpses into bankruptcy filing patterns. The Cato study cited surveys that found that 45 percent of consumer bankruptcy filers learned about bankruptcy from friends or family. Ten percent of filers were identified by Cato as repeat filers, and 27 percent said they would consider filing again. Our small credit union has had at least two repeat filers who did not reveal their previous bankruptcies because they were past the time limit.

As suggested, there are many reasons why there is an absence of stigma, and certainly one of those reasons is the prevalence of attorneys who specialize in bankruptcy filings. In our area, the media, especially television, newspapers, and household mailings, is saturated with advertisements from bankruptcy attorneys offering to "relieve the pressure of monthly payments."

Preserve Bankruptcy for Those Who Need It

To be sure, not every bankruptcy filing is abusive. There is no question that the need for protection from creditors is something that consumers who truly need it should have access to, and something that credit unions favor. We could not endorse a bill that denies people necessary bankruptcy protection. We all know of situations where a member is the victim of unforeseen financial calamity, often associated with the loss of a job, a divorce, or illness. But we can support this bill because it does provide that protection, it does improve the position of filers from current law in a number of areas, and it does discourage the abuse that has come to characterize the bankruptcy system. We recognize that there are those that disagree with this position, and we pledge that should this bill become law and result in unintended consequences that adversely impact those that truly need bankruptcy protection, we will be the first ones in line seeking a legislative correction to the problems.

Credit Unions Support Financial Education

Credit unions clearly recognize the value of financial counseling for their members. According to a recent CUNA bankruptcy survey, 70 percent of credit unions counsel financially troubled members at the credit union. A similar percentage of credit unions may also refer members to an outside financial counseling organization, such as the Consumer Credit Counseling Service (CCCS), and many do both.

Palmetto Trust regularly refers members who are experiencing financial difficulties to the local CCCS and have found the program to be beneficial for the members and their families. We also try to educate our members about alternatives to bankruptcy.

CUNA strongly supports the provisions in H.R. 975 that establish the principle that people need information and assistance to understand what bankruptcy means and how to avoid financial problems. For example, the bill requires a person contemplating bankruptcy to receive a briefing about available credit counseling and assistance in performing a budget analysis. The bill also would prohibit the Chapter 7 or 13 debtor from receiving a discharge if the debtor does not complete a course in personal financial management. Any sensible bankruptcy reform should include education requirements to give debtors the tools they need to make wise decisions about filing for bankruptcy and to succeed financially after bankruptcy.

Credit unions recognize that financial education needs to be available early on and before consumers experience financial problems. We are pleased that a financial management training test program is included as part of H.R. 975, as well as the provision encouraging states to develop personal finance curricula for elementary and high schools.

CUNA actively supported the Youth Financial Education Act promoted by Representatives David Dreier (R-CA) and Earl Pomeroy (D-ND). This legislation authorized the U.S. Department of Education to provide grants to state educational agencies to develop and integrate youth financial education programs. It would also require these funds to be used to carry out programs for students in kindergarten through grade 12, based on the concept of achieving financial literacy through the teaching of personal financial management skills, and the basic principles involved with earning, spending, saving and investing.

Financial education is a high priority for our national trade association. CUNA is a partner with the National Endowment for Financial Education (NEFE) and the Department of Agriculture's Cooperative Extension Service in which credit union volunteers teach financial education in our nation's schools. It is based on the philosophy that discipline in managing money is best achieved if it is learned early in life. Many credit unions had already been working with their local schools, as well as devoting office space for consumer libraries that enable members to use a wide range of financial periodicals, manuals, and books to learn more about money management. We are currently exploring ways to offer this program to adults in underserved communities. And CUNA has further made financial literacy a high priority in its role as a Board member of the Jump$tart Coalition for Personal Financial Literacy.

Credit unions have also differentiated themselves from other financial institutions in terms of giving college students credit cards. Many credit unions offer educational sessions on budgeting and using credit wisely on college and university campuses at various times during the year, including freshmen orientation and classes. Education is the key in helping college students to avoid falling into debt at an age where their main focus is on obtaining a college degree. By educating these students, credit unions help them to positively handle their personal finances and to make them even more attractive candidates for credit products such as auto loans and mortgages later in life. Many colleges and universities welcome credit union representatives to teach these courses on their respective campuses and continually ask these representatives to come back year after year.

Credit Unions Support Reaffirmations as a Benefit Both to the Member and to the Credit Union

Because we are not-for-profit financial cooperatives, losses to the credit union have a direct impact on the entire membership due to a potential increase to loan rates or decrease in interest on savings accounts. Credit unions strongly believe that reaffirmations are a benefit both to the credit union, which does not suffer a loss, and to the member/debtor, who by reaffirming with the credit union continues to have access to financial services and to reasonably priced credit. CUNA could not have supported bankruptcy reform legislation if the bill would have undermined the ability of credit unions and their members to work out reaffirmation agreements.

CUNA strongly supported the original House-passed bankruptcy bill in the 106th Congress, which did not materially amend the reaffirmation provisions. This version of the bankruptcy bill, however, contains a lengthy disclosure statement for reaffirmations. The form is intended to assure that debtors entering into a reaffirmation agreement understand all aspects of signing that contract. CUNA appreciates that the bill modifies these forms in recognition of the unique relationships that credit unions have with their members.

Palmetto Trust, like most credit unions, has a policy that if a member causes a loss to the credit union, services to that member, aside from maintaining a share account, will be withheld. Most credit union members take this seriously and continue to reaffirm on their credit union loans. However, we are beginning to see that some members do not care if they cause a loss and are denied service because they believe they can get credit elsewhere -- even though it may be at a higher rate. We continue to see more surprise bankruptcies, where the member is a long-time member and is current on his or her debt at the time the bankruptcy petition is received.

Credit Unions Support Needs-Based Bankruptcy

- Credit unions are very anxious to see Congress enact meaningful bankruptcy reform and believe that "needs-based bankruptcy" presents the best opportunity to achieve this important public policy goal. Credit unions believe that consumers who have the ability to repay all or some part of their debts should be required to file a Chapter 13, rather than have all their debt erased in Chapter 7.

Therefore, CUNA supports the needs-based provision that is contained in H.R. 975.

- This "needs test" will allow courts throughout the country to consistently evaluate if a person is possibly abusing the bankruptcy system by looking at his income and expected reasonable expenses. This assessment allows the court to determine whether the response to the debtor's request for relief should be to wipe out most debts in Chapter 7 bankruptcy or should be to reorganize and reduce his debts in Chapter 13 bankruptcy.

- The vast majority of people who seek bankruptcy -- because of job loss, medical problems, divorce and other personal problems -- will be unaffected by this provision. Less than 10 per cent of the people who file for bankruptcy annually will have trouble meeting the "needs test." However, since more than one million people file for bankruptcy annually, this is still a potentially large number of people who may have the means to repay at least some of their unsecured debts in Chapter 13.

- Even if the test, which compares the person's income and presumed expenses, seems to show that the bankruptcy relief sought is not necessary, the person filing for bankruptcy will be able to show why there are special family circumstances which justify a higher expense allowance than built into the "needs test" calculations. Moreover, government agencies are instructed to evaluate if the expense standards used in the bill are appropriate.

Conclusion

Mr. Chairman, all of this adds up to a bill that would create a fairer and more realistic bankruptcy code. Credit union members, because they own their institutions, feel the effects of abusive bankruptcies directly. And while no one is arguing that the bankruptcy legislation will completely eliminate abuses, no one should argue that the bill isn't necessary because it isn't perfect.

It is our hope that this important legislation finally becomes law, that judges carefully follow the new law so that they take a more realistic view of people's capacity to repay their debts, and, perhaps most importantly, a renewed sense of individual accountability becomes apparent.

Thank you, and I will be happy to answer any questions.

Mr. CANNON. We recognize the temporary presence of the Ranking Member of the full Committee, Mr. Conyers of Michigan, and, Ms. Miller, if you would like to proceed, I will give you 5 minutes now. Thank you.

STATEMENT OF JUDITH GREENSTONE MILLER, ESQUIRE, RAYMOND & PROKOP, P.C., SOUTHFIELD MICHIGAN, ON BEHALF OF THE COMMERCIAL LAW LEAGUE OF AMERICA

Ms. MILLER. Thank you. Good afternoon, and thank you for inviting me to testify before the Subcommittee on behalf of the Commercial Law League of America. The league, founded in 1895, is the Nation' oldest creditors' rights organization, comprised of attorneys and other experts in credit and finance actively engaged in the fields of bankruptcy, insolvency, reorganization and commercial law. The league has long been associated with creditor interests, while at the same time seeking fair, efficient and equitable administration of bankruptcy cases for all parties in interest.

The league has consistently advocated that bankruptcy laws must strike a balance that is both fundamentally fair and practically sound for all parties involved. The bankruptcy legislation that has been proposed the last three Congresses and most recently introduced in almost the identical form last Thursday is neither fair nor practically sound. It is unfortunate that the legislation was again introduced prior to the conclusion of findings of this Subcommittee, because in essence, the premise, fears and conditions underlying the original perceived need for bankruptcy reform 6 years ago do not exist. Moreover, the changes that have occurred over the last 18 months, such as the changed economy, 9/11 and the megabankruptcy filings such as Enron, WorldCom, K-Mart and the major airlines, suggests that not only the perceived need for bankruptcy reform be reevaluated, but the consideration be given to the real abuses and true issues in the Code.

Bankruptcy is a delicate and complicated process. It is more than simply a two-party dispute between the debtor on one side and the creditors on the other. Rather, multiple parties and constituents, often with varying different interests, play significant roles in the process. Therefore, any reform must take into consideration not only the interests of the particular party seeking redress but also the impact on the system as a whole. The legislation suffers from such infirmities.

First the majority of the hearings thus far have focused on the consumer rather than the business issues. The business issues must be subject to the same attention before enacted in a tenuous economy.

Second, the final bill that ultimately evolved from the conference committee had numerous amendments, many of which had not been subject to prior comments, hearings or careful analysis. They also catered to many special interests at the expense of the general body of unsecured creditors as a whole. For example, the provisions for real estate lessors who already have enhancements in the Code are further enhanced at the expense of the debtor and the unsecured creditors. Moreover, lien stripping in Chapter 13 cases is severely limited by the bill in direct contravention of the stated purpose for reform, being greater repayment to unsecured creditors. It has been estimated that unsecured creditors will lose in distributions from the passage of this provision as much as 100 million annually.

Third, despite the numerous amendments proffered as part of the legislation, real issues that currently confront the system haven't been considered, such as forum non-conveniens and standing to pursue causes of action. It bears note that throughout the last 6 years that the legislation has been pending in Congress, it has been consistently criticized by every major bankruptcy organization, bankruptcy professionals, judges, trustees and scholars. The bill, however, does contain some noncontroversial and much-needed reforms that, if passed, would enhance and provide significant benefits to the overall system.

For example, Chapter 12, cross-border provisions, new judgeships, DePrizio, Claremont, Catapult, all of these provisions have been held hostage as placeholders with the hope that pressure for enactment of these individual reforms would ultimately fuel passage of the entire bill. Much acknowledged needed reforms have been held at bay. Instead, Congress has repeatedly reintroduced the same basic legislation rather than reevaluating the need for reform; and if so, on what basis.

Reform was first suggested in 1994. At that time we were facing unprecedented growth and prosperity. The individual filings had reached and all-time high, and Congress perceived that many individual debtors were abusing the system and that filings would rise. While filings may have incrementally increased since that time, it has not been due to merely seeking to escape one's obligations, but real financial need, such as divorce, medical bills, loss of jobs, 9/11, displaced military personnel, corporate downsizing and uncertainty regarding the state of the bankruptcy law. Today's Washington Post cover story focuses on the financial hardship particularly being faced by displaced military personnel.

Relying simply on the number of filings as a barometer is dangerous and misleading. The statistics in 2002 suggests that business bankruptcies declined. Nevertheless, it is indisputable it was the year of the large business bankruptcy. The country has still not begun to face all the repercussions that are likely to result from such large filings. Therefore, prior to enacting legislation that will create sweeping changes at a time when financial relief is likely to be needed the most, Congress must pause, take a step back and carefully analyze and reexamine that which it has proposed against the current realities and needs for the system of creditors and debtors alike.

Thank you very much, and I would be pleased to answer questions.

Mr. CANNON. Thank you, Ms. Miller.

[The prepared statement of Ms. Miller follows:]

PREPARED STATEMENT OF JUDITH GREENSTONE MILLER

Good afternoon. Thank you for inviting me to testify before the Subcommittee on behalf of the Commercial Law League of America ("League"). The League, founded in 1895, is the nation's oldest creditors' rights organization, comprised of attorneys and other experts in credit and finance, actively engaged in the fields of bankruptcy, insolvency, reorganization and commercial law. The League has long been associated with creditor interests, while at the same time seeking fair, equitable and efficient administration of bankruptcy cases for all parties in interest. The Bankruptcy Section, comprised of 1,200 bankruptcy professionals (lawyers, judges and other workout professionals) from across the country, represents divergent interests in bankruptcy cases. The League has testified on numerous occasions and submitted position papers before Congress as experts in the bankruptcy and reorganization fields.

The League has consistently advocated that bankruptcy laws must strike a balance that is both fundamentally fair and practically sound for all parties involved. The bankruptcy legislation that has been proposed the last three Congresses, and most recently introduced in almost the identical form last Thursday, February 27, 2003, is neither fair nor practically sound. It is unfortunate that the legislation was again introduced prior to the conclusion and findings of this Subcommittee, because, in essence, the premise, fears and conditions underlying the original perceived need for bankruptcy reform six years ago do not exist. Moreover, the changes that have occurred over the last eighteen months, such as the changed economy, the terrorist events of 9-11 and the mega-bankruptcy filings, such as Enron, WorldCom, K-Mart and the major airlines, suggest that not only the need for bankruptcy reform be reviewed and analyzed, but moreover, that consideration be given to the real abuses and true issues that need to be addressed as the Bankruptcy Code ("Code") currently exists.

Bankruptcy is a delicate and complicated process. It is more than simply a two-party dispute between the debtor on the one side, and creditors on the other. Rather, multiple parties and constituents, often with vastly different interests and goals, play significant roles in the overall process. Therefore, any reform effort must take into consideration not only the interests of the particular party seeking redress, but also the overall impact on the bankruptcy estate as a whole. This legislation suffers from such infirmities.

First, the majority of the hearings devoted to the legislation have focused on consumer, rather than business issues. The business issues must be subject to the same attention before enacted in a tenuous economy.

Second, the final bill that ultimately evolved from the conference committee had numerous amendments, many of which have not been subject to prior comment, hearings or careful analysis regarding their impact and consequences on the system. Many of these amendments, like the overall bill, cater to special interests, thereby enhancing the right of a few at the expense of the general body of creditors of the estate. For example, lessors of non-residential real property currently have extensive power over debtor lessees. Despite the protections already contained in the Code, the legislation seeks to enhance their rights in a manner that is likely to deprive the debtor and the unsecured creditors of valuable assets of the estate needed to reorganize or alternatively create large administrative priority claims from a pressured, and subsequently determined to be an improvident assumption. Lien stripping in Chapter 13 cases is also severely limited by the bill in direct contravention of the stated purpose for reform—greater repayment to unsecured creditors. Losses to unsecured creditors from passage of this proposal have been estimated to approach $100 million annually. The League has repeatedly objected to legislation that favors special limited interests as being fundamentally unfair and inappropriate to the creditors of the estate.

Third, despite the numerous amendments proffered as part of the legislation, real issues that currently confront the system haven't even been considered. For example, the issue of *forum non-conveniens*, governing the location where a bankruptcy case should be filed so as not to negatively impact the creditors, is not addressed in the bill. The administration of a bankruptcy case is often dealt with in a location that has minimal contacts to the operation and assets of the debtor.

Moreover, in a number of the large national corporate scandals and mega-filings, many of which were precipitated by fraudulent conduct, one of the major assets that creditors' committees seek to pursue in order to provide recovery and a distribution to the creditors is causes of action against the officers, directors, principals and affiliates, i.e., the "insiders." Generally, the actions allege breaches of fiduciary duties, transfers of assets on the eve of bankruptcy and other improper and/or fraudulent conduct. Standing to pursue such avoidance actions on behalf of the creditors has been seriously questioned by some courts recently based on rules of statutory construction that preclude a court from looking at legislative intent and history.

The Third Circuit Court of Appeals in *Official Committee of Unsecured Creditors of Cybergenics Corp.* v. *Chinery (In re Cybergenics Corp.)*, 304 F.3d 316 (3rd Cir. 2002), *vacated*, 310 F.3d 785 (3rd Cir. 2002), interpreted Section 1103(a) of the Code to preclude the creditors' committee from pursuing avoidance actions based on its use of the phrase "the trustee may," to imply a limitation of those parties-in-interest that may actually proceed to avoid impermissible transfers. In a number of instances, debtors and debtors-in-possession refuse or fail to act because it would require them to sue their own principals, officers, directors and affiliates to seek recovery of assets improperly transferred to them prior to or on the eve of bankruptcy. While the initial decision of the court has been vacated for rehearing and determination by the entire Third Circuit, this holding, if upheld, will make it increasingly difficult for creditors to seek recovery of valuable assets.

It bears note that throughout the last six years that the legislation has been pending in Congress, it has been consistently criticized by every major bankruptcy organization, bankruptcy professionals and scholars. The bill, however, does contain some noncontroversial and much needed reforms, that if passed, would enhance and provide significant benefits to the overall system. Such things, for example as, the permanent extension of Chapter 12, adoption of the international cross-border provisions contained in chapter 15 of the bill, the addition of thirty-six (36) new bankruptcy judgeships, cure and elimination of the *DePrizio* problem in Sections 547 and 550 of the Code, elimination of the *Claremont* nonmonetary penalty cure under Section 365(d)(2) of the Code, remediation and clarification of the ability to assign and assume personal services contracts and other nonassignable interests under Section 365(c) in response to *Catapult*, rules governing appellate procedure of bankruptcy cases and trustee liability and removal provisions, have been held hostage, as placeholders, with the hope that pressure for enactment of these individual reforms would ultimately fuel passage of the entire bill. Much acknowledged and needed reforms have been held at bay. Instead, Congress has repeatedly reintroduced the same basic legislation, rather than reevaluating the need for reform legislation, and if so, on what basis.

Congress first suggested the need to review and address bankruptcy reform as part of the 1994 amendments to the Code through the creation of the National Bankruptcy Review Commission ("Commission"). Even before the Commission issued its final report, Congress introduced the legislation. At that time, we were facing unprecedented growth and prosperity in the country. At the same time, individual bankruptcy filings had reached an all time high. Congress perceived that many individual debtors were abusing the system and that filings would continue to rise. While filings may have incrementally increased since that time, the individual filings, in large part, have been attributable to real needs triggering financial relief (i.e., divorce, medical bills, loss of jobs, 9-11, displaced military personnel, corporate downsizing and uncertainty that the current pending legislation and its predecessors would be enacted into law by Congress), not merely to escape one's obligations.

Relying simply on the number of filings as a barometer is dangerous and misleading. For example, while the statistics of filings for 2002 suggest that business bankruptcies declined, it is indisputable, based on the number of mega-filings during that time, that 2002 will go down as the year of large business bankruptcies. The country still has not even begun to face all of the repercussions that are likely to result from these large filings, such as closure of facilities, decreased work forces and elimination of retirement benefits. The economic climate of the country has also changed dramatically since bankruptcy reform was first envisioned. The reticence of the country to expend resources in the wake of 9-11 and the continued fears of war and terrorism suggest that recovery is going to be slow at best. Therefore, prior to enacting legislation that will create sweeping changes, at a time when financial relief is likely to be needed the most, Congress must pause, take a step back, and carefully analyze and reexamine that which it has proposed against the current realities and needs of the system for debtors and creditors alike.

Thank you for the opportunity to address the Subcommittee this afternoon. In addition to the filing of this written testimony, the League has also submitted a written position paper setting forth its critical issues for consideration by Congress.

CLLA

Position Paper Submitted to the United States Congress
by the Commercial Law League of America
and its Bankruptcy Section

Critical Substantive Issues for Meaningful Bankruptcy Reform

March 3, 2003

The Commercial Law League of America ("CLLA"), founded in 1895, is the nation's oldest organization of attorneys and other experts in credit and finance actively engaged in the field of commercial law, bankruptcy and reorganization. Its membership exceeds 3,900 individuals. The CLLA has long been associated with the representation of creditor interests, while at the same time seeking fair, equitable and efficient administration of bankruptcy cases for all parties in interest.

The Bankruptcy Section of the CLLA is made up of approximately 1,200 bankruptcy lawyers and bankruptcy judges from virtually every state in the United States. Its members include practitioners with both small and large practices, who represent divergent interests in bankruptcy cases. The CLLA has testified on numerous occasions before Congress as experts in the bankruptcy and reorganization fields.

Most of the debate over bankruptcy reform has focused on consumer issues, i.e., means testing, in an attempt to channel more consumer debtors into repayment plans. While the CLLA believes reassessment of this and other consumer issues are an important element of ongoing bankruptcy reform efforts, the complex provisions previously proposed in reforming the Bankruptcy Code (the "Code") reach far beyond consumer issues. Virtually overlooked in this debate are many other changes that could affect businesses and their ability to successfully reorganize. These changes must be given careful consideration, particularly in view of the increasing pressure on businesses to perform in the current financial climate.

The CLLA has actively participated in the bankruptcy reform process and has commented extensively on various legislative initiatives introduced since the 105th Congress. The purpose of this Position Paper is to set forth for consideration the substantive provisions that the CLLA believes are critical for the achievement of effective and meaningful bankruptcy reform. Although a full analysis of these critical issues is attached as Exhibit A, they may be summarized as follows:

- Venue for corporate debtors should be limited to the district in which the corporation has its principal place of business to prevent forum shopping and to ensure active participation by all interested parties, including consumers, workers, and retirees.

- A "fast track" Chapter 11 mechanism for small business debtors is unwise and should not be enacted. Any such provisions that are proposed should take account not only the size of the debtor, but also the practical realities of such cases.

- Should specialized small business reorganization provisions be retained, the duties of a small business debtor specifically set forth should be realistic from the standpoint of the availability of the information to the debtor and the value of such information to parties in interest.

- The serial filer provision, although necessary to curb abuse of the chapter 11 process, requires revision in order to carry out Congressional intent.

- Chapter 12, governing the reorganization of family farmers, must be made permanent.

- Provisions governing the unique circumstances that arise in cross-border insolvencies should be added to the Code.

- Lessors of non-residential real property currently have extensive power over debtor lessees. No further landlord protections should be enacted because lessors are already treated in a fair and balanced manner in the Code.

- Present law governing the assumption and assignment of "personal service contracts" requires revision to enable debtors to successfully reorganize and, at the same time, prevent trustees from compelling performance where it is undesirable or inappropriate.

- An amendment to current law is required to allow trustees to assume executory contracts without curing a breach arising from a non-penalty provision relating to the debtor's failure to perform non-monetary obligations.

- Additional bankruptcy judgeships must be authorized if the integrity of the bankruptcy system and the quality of its jurists is to be maintained.

- The definition of disinterestedness requires clarification so that professionals with only minor potential conflicts are not precluded from retention on behalf of the bankruptcy estate, provided that full disclosure is made by such professionals to the court.

- Committees of unsecured creditors should be expressly empowered to undertake statutory actions where the debtor in possession unjustifiably fails or refuses to do so.

- The CLLA supports changes to the law concerning avoidance of preferential payments, and believes further improvements are warranted to properly carry out Congressional intent.

- Restrictions on the transfer of assets by nonprofit charitable corporations could have a devastating effect in the health care industry. Ultimately, unsecured creditors and patients will bear the consequence of these unwarranted restrictions.

- A homestead exemption cap must be adopted and be accompanied by language expressly precluding states from opting out. Otherwise, the current abuse by the affluent of shielding assets from creditors and forum shopping will not cease.

- Lien stripping in chapter 13 cases has been severely limited by bankruptcy reform legislation in direct contradiction of the stated purpose for bankruptcy reform, that is, greater repayment to unsecured creditors. Losses to unsecured creditors from passage of this proposal have been estimated to approach $100 million annually.

In addition to the attached full analysis of these issues, the CLLA has also attached to this Position Paper suggested language to amend various provisions of Code. We hope that this analysis and the accompanying suggested language will enable the United States Congress to achieve effective and meaningful bankruptcy reform for all parties in interest.

Respectfully submitted,

John P. Wanderer
President
Commercial Law League of America

Judith Greenstone Miller
Co-Chair, National Governmental Affairs Committee
Chair, Bankruptcy Section
Commercial Law League of America

Jay L. Welford
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Co-Chair, Legislative Committee

Peter C. Califano
Co-Chair, Legislative Committee
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EXHIBIT A

Analysis of Critical Substantive Issues for Meaningful Bankruptcy Reform

Submitted to the United States Congress
by the Commercial Law League of America
and its Bankruptcy Section

March 3, 2003

The Commercial Law League of America ("CLLA"), founded in 1895, is the nation's oldest organization of attorneys and other experts in credit and finance actively engaged in the field of commercial law, bankruptcy and reorganization. Its membership exceeds 3,900 individuals. The CLLA has long been associated with the representation of creditor interests, while at the same time seeking fair, equitable and efficient administration of bankruptcy cases for all parties in interest.

The Bankruptcy Section of the CLLA is made up of approximately 1,200 bankruptcy lawyers and bankruptcy judges from virtually every state in the United States. Its members include practitioners with both small and large practices, who represent divergent interests in bankruptcy cases. The CLLA has testified on numerous occasions before Congress as experts in the bankruptcy and reorganization fields.

Forum Shopping

A principal concern of the CLLA is the need for an amendment requiring that domicile and residence for venue of corporate debtors be conclusively presumed to be the location of the debtor's principal place of business without regard to the debtor's state of incorporation. Such a change would benefit creditors and prevent an unacceptable degree of forum shopping by debtors who are in search of a venue that will be friendly to its needs. More important, however, requiring that a corporate bankruptcy take place locally ensures that the distinct needs of the community are not overlooked or, worse, ignored by a group of professionals residing hundreds of miles away.

The consequences of a corporate bankruptcy are often most profound in the community in which the debtor's principal place of business is located, especially in the relatively smaller cases. Not only are there typically more jobs involved locally, but also the local economy will depend, to a large extent, on business from that debtor. Many critical issues of local importance arise. The debtor may be, for example, one of the community's larger employers, or it may sustain many small businesses that provide various goods and services. The consequences could extend even further, affecting the number of hospital beds that are available, the quality of elder care, or even waste removal. These are but a few of the countless possible issues and each affected community has a vested interest in the outcome of the debtor's case.

Those affected by a corporate bankruptcy have the right to believe that their interests are being adjudicated fairly and openly in their own communities. Permitting a bankruptcy filing in a distant forum effectively bars many creditors – especially those who are most vulnerable such as consumers, workers, retirees, or small trade creditors – from participating in the bankruptcy process based on nothing more than their inability to afford the travel expenses. It is not enough that the Code provides for the appointment of an unsecured creditors' committee because such committees are not always appointed and, even where there is an active committee, its members will likely be the debtor's largest creditors whose interests differ from or even conflict with those of smaller, less powerful, creditors.

More fundamentally, allowing the practice of forum shopping by debtors undermines the bankruptcy process and creates unwarranted competition among the courts. Before filing, the debtor is able to determine which courts have taken friendly views of the debtor's particular needs and select such a court with the intent of creating a disadvantage for creditors. Indeed, some corporate debtors have even commenced bankruptcy cases for a financially healthy subsidiary solely to acquire the preferred venue.

Much has been said among members of Congress that bankruptcy reform is necessary to prevent what it perceives as abuse of the bankruptcy process. A venue provision that requires corporate bankruptcies to be filed at the principal place of business furthers that goal and ensures that the distinct needs of the affected communities are not overlooked, avoided or ignored and provides due process to all parties involved. Suggested language for such a provision is attached as Exhibit 1; Exhibit 8 presents a case that exemplifies the inappropriate use of the state of incorporation venue option.

<u>Small Business Bankruptcy</u>

1. "Fast Track" Chapter 11 Reorganization

The CLLA is generally opposed to the creation of a "fast track" Chapter 11 procedure for small businesses. The underlying assumption of such provisions, that the size of the business is determinative of the complexity of the case, is simply not true, as shown in the examples set forth in Exhibit 7. Indeed, the very opposite may be true because large cases typically have creditors of equal size and sophistication, while in the small business case, creditors tend to be more leery of the bankruptcy process, which causes greater operating concerns that need time to settle.

Moreover, the operations of small business debtors are extremely varied. The availability of raw materials to manufacture goods or the sources of merchandise to maintain inventories are not all the same. The desirability of the location of their physical facilities varies depending on the cities in which they operate. The reasons why small businesses seek bankruptcy protection are not all based on a bad economy, poor management, or incomplete books and records.

Viewed generally, proposals to streamline small business bankruptcies appear intended to address systematic abuses that do not exist on a scale that would demand dramatic reform, especially reform that would ensure the liquidation of otherwise viable businesses that are capable of successful reorganization.

2. Duties in a Small Business Case

Should specialized small business reorganization provisions nevertheless be considered, the CLLA believes that a debtor/debtor in possession should be required to file a statement within three days after the case is commenced verifying that it has been informed of its duties.

The CLLA further believes that the reporting requirements previously considered are both unworkable and onerous. Accordingly, the CLLA suggests that the financial information required to be filed by a debtor consist of the following most recent financial documents prepared on a monthly or quarterly basis during the one year preceding the filing of the bankruptcy petition: (i) tax returns, (ii) balance sheet, (iii) income statements, and (iv) cash flow statements. This information is more likely to be in the possession of or readily obtainable by the debtor. Moreover, this information is more accurate in setting forth the status of the debtor and identifying the problems that led to the bankruptcy filing, facilitating a plan for reorganizing.

3. Serial Filer Provisions

The CLLA agrees that a remedy is needed to curb abusive serial bankruptcy filings. However, remedial efforts have tended to focus only on small business serial filings. It is not clear why such a proposed remedy should apply only in small business cases, rather than in all business cases that are abusive. The standards for imposing a stay to protect the estate for the benefit of creditors should not depend on a debtor's size or form of organization. Further, the CLLA believes that the period between bankruptcies in which a presumption of abuse arises should not exceed 18 months. Finally, bona fide purchasers of assets from a bankruptcy estate should not be subjected to these same restrictions on the automatic stay.

Family Farmer Bankruptcy

The CLLA strongly supports making permanent the provisions of Chapter 12 of the Code, which provide a specially tailored reorganization process for family farmers. Prior to the enactment of Chapter 12, many family farmer bankruptcies failed simply because the existing Bankruptcy Code provisions were unworkable in the unique circumstances involved in farming operations. Since its enactment, Chapter 12 has by all accounts proven successful and there is no evidence that Chapter 12 is not fulfilling the purpose it was intended to serve.

Since Congress first considered overhauling the nation's bankruptcy laws in the 105th Congress, family farmers have been subjected to continued uncertainty because the provisions of Chapter 12 have expired and been extended on numerous occasions. In fact, there have been gap periods during which there was no authority for family farmers to utilize the Chapter's provisions.

All the while, however, Congress expressed its clear intent that Chapter 12 should be made permanent. Doing so now, irrespective of any other decision Congress might make regarding other aspects of the Code, is the only means of ensuring fairness and predictability for family farmers and their creditors.

Cross-Border Bankruptcy/Insolvency

Many leading experts in the field of international insolvency have advocated for some time that the Code be amended to add a new chapter specifically tailored to address the unique problems that arise when a financially distressed company has interests that span the globe. Toward this end, the United Nations Commission on

International Trade Law ("UNCITRAL") has promulgated its Model Law on Cross-Border Insolvency.

According to UNCITRAL's Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency, the insolvency laws of various nations have not kept pace with the increasing expansion of global trade and investment. This hinders the liquidation or rehabilitation of distressed businesses in a variety of ways and ultimately works to the detriment of creditors.

The CLLA, whose members include international credit, collections, and bankruptcy professionals, is in agreement with the concept of incorporating a cross-border insolvency chapter into the Bankruptcy Code, so long as it is consistent with UNCITRAL.

Executory Contracts and Unexpired Leases

1. Unexpired Nonresidential Real Property Leases

Strict time periods within which leases of nonresidential real property must be assumed or rejected are inappropriate and unworkable, especially if consent of the lessor is required to obtain an extension of that time. Such a proposal has been considered as a part of bankruptcy reform, but should not be included as it will make the reorganization of businesses that have multiple commercial locations virtually impossible. Although the time period for assumption or rejection of unexpired leases of nonresidential real property has been increased from the Code's current 60 days, the court would have no discretion to grant an extension of this time period. Rather, the only way the time period may be extended is with the consent of the landlord. This change vests too much power with the landlords, will harm unsecured creditors and the debtor, and will place landlords in the position of exerting pressure and seeking concessions in exchange for granting the debtor an extension.

Current law is working well. Landlords have appropriate safeguards, including a statutory requirement that debtors timely pay postpetition rent, administrative priority treatment for postpetition rent not paid, and a 60 day period during which the lease must be assumed or rejected with extensions by the court upon a showing of cause. If additional remedies are needed for lessors, a more appropriate response would be to provide other sanctions for debtors' failure to pay rent. However, under current law, landlords are receiving what they bargained for – they are paid their rent, and if they are not paid, then they receive the highest priority claim.

Notwithstanding, the CLLA recognizes that the Congress may desire to limit the court's discretion in granting extensions of the period in which unexpired leases of nonresidential real property must be assumed or rejected. Toward that end, suggested language is attached as Exhibit 2.

2. Assignability of Personal Service Contracts

An amendment to Section 365(c)(1) of the Code is needed to address the substantive difference between the trustee and the debtor in possession when it relates to the assumption of a "personal service contract." Confusion has existed since the enactment of the 1978 Code that has come to the forefront as a result of the Ninth Circuit Court of Appeals' "*Catapult*" decision. *See Perlman v. Catapult Entertainment, Inc. (In re Catapult Entertainment, Inc.)*, 165 F.3d 747 (9th Cir. 1999), *cert. denied*, 528 U.S. 924 (1999), (debtor in possession cannot assume an executory contract without consent of the nondebtor party if applicable nonbankruptcy law precludes assignment, even though debtor does not intend to assign the contract).

When Section 365(c)(1) was originally adopted, its purpose was to prohibit a trustee from assuming or assigning a contract that by its terms was personal to the debtor, and therefore, not assignable under applicable bankruptcy law. For example, if Mark McGuire filed bankruptcy, the trustee should not be able to effectuate an assumption and assignment of his contract, but McGuire, individually, should be able to assume the contract. Unfortunately, the provision was never quite drafted correctly, and the technical amendments in 1984 made it worse. Moreover, the legislative attempt to prohibit the assignment of "personal service contracts" by its terms and original intent was broader than just "personal service contracts." Neither version expressly permitted the debtor to assume the "personal service contract" or prohibited the nondebtor party from terminating the contract.

A debtor in possession should be able to assume his or her own "personal service contract," as well as other contracts that fit within Section 365(c)(1) but which are not personal to the debtor, as that may be the only way for the reorganization to create any cash flow. So long as the nondebtor party is receiving the benefit of its bargain and will continue to receive that benefit postconfirmation from the entity with which it contracted, there is no reason to deprive the debtor of a vital asset it may need to retain in order to successfully reorganize. Language contained in attached Exhibit 3 would resolve the problems attendant to Section 365(c)(1) and the *Catapult* decision.

3. Defaults Based on Nonmonetary Obligations

Prior versions of the bankruptcy reform legislation have sought to correct what was viewed by virtually everyone but the 9th Circuit as a drafting issue. The genesis for amending Section 365(b)(2)(D) of the Code is the decision by the Ninth Circuit Court of Appeals in *Worthington v. General Motors Corp. (In re Claremont Acceptance Corp.)*, 113 F.3d 1029 (1997).

The concept underlying the original statute was that the trustee cannot assume any executory contract without curing defaults. The Code makes an exception, excusing from the trustee's performance

> the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

11 U.S.C. § 365(b)(2)(D).

Claremont and some other courts have interpreted this phrase such that "penalty" modifies both "rate" and "provision." Although this interpretation may be correct as a matter of statutory construction, it nevertheless impairs the trustee's ability to act in the best interests of the estate. Oftentimes, nonmonetary defaults are not capable of being cured, thereby precluding assumption of a valuable executory contract of the estate. In *Claremont*, for example, the business subject to the contract had been closed for a period of time that exceeded what the contract permitted. Cure was impossible and the court accordingly held the contract could not be assumed. Such a result was not intended by the drafters of the Code and should be remedied. Suggested language is attached as Exhibit 4.

<u>Bankruptcy Professionals, Committees, and the Courts</u>

1. Bankruptcy Judgeships

There is a clear need to increase the number of bankruptcy judgeships. According to the Judicial Conference of the United States, since Congress last authorized additional judgeships in 1992, the courts' caseloads have increased by 59 percent. In addition to an increase in the overall number of bankruptcy filings since 1992, the bankruptcy courts have seen the size and complexity of their business cases grow as well, placing further strain on the courts' resources.

Without additional judgeships, serious consequences are likely. Delays in the administration of cases are costly to creditors, who must await payment for no other reason than the sheer volume of work to be done, while debtors are hindered in their ability to receive bankruptcy's fresh start. Moreover, faced with burdensome or seemingly unmanageable workloads, highly competent and qualified jurists may abandon the bench in the belief that they are simply unable to properly administer justice in such a constrained environment.

Adding bankruptcy judgeships would alleviate the current burden on the bankruptcy courts, avoid the potential consequences of taking no action, and ensure that the Code and justice itself are properly administered.

There has been no serious objection to this proposal. Rather, Congress has refused to grant such acknowledged needed relief outside the context of an overall bill with hopes that the pressure from not moving forward on this issue would ultimately aid support for the overall bills. This has not happened.

2. Disinterestedness

Past bankruptcy reform measures have made minor amendments to the definition of disinterestedness, but have failed to address concerns about potential conflicts that could preclude the appointment of a professional in a case.

To be disinterested under present law, an entity may not have "any direct or indirect relationship to, connection with, or interest in, the debtor." This phrase, contained in Section 101(14) of the Code, has been interpreted by some courts quite broadly to preclude retention of individuals and/or entities when they have "any connection" to the debtor even though such connection is not "materially adverse" and even after full disclosure of all connections has been made as part of the retention process under applicable Federal Rules of Bankruptcy Procedure. *See e.g.* Fed. R. Bankr. P. 2014. *See also* 11 U.S.C. § 327.

The CLLA believes the statute should be amended to provide that any person seeking to be retained in a bankruptcy case make full disclosure of any relationship to, connection with, or interest in, the debtor. Based on that disclosure, the court would then be in a position to determine if any interest disclosed is materially adverse to the estate and, if not, the retention of the professional should be approved. Adoption of this standard would permit the retention of professionals who have minor connections with the estate, so long as such connection is not found by the court to be materially adverse to the estate. A process requiring full disclosure and determination by the court sufficiently protects the estate from any potential conflict of interest or abuse.

3. Rights, Powers, and Duties of the Unsecured Creditors Committee

Section 1103(c) of the Code should be amended to expressly permit official committees of unsecured creditors in Chapter 11 cases to pursue remedies provided under the Code that are currently afforded only to the debtor in possession or, if appointed, the trustee.

The problem in this respect does not represent a significant change or substantive alteration from that which has been taking place, but rather an anomaly based upon rules of statutory construction. The Code provides that a variety of transactions can be avoided for the benefit of unsecured creditors of the estate under certain defined circumstances, including those that are fraudulent, preferential, or not properly perfected.

The Code expressly permits the Chapter 11 debtor in possession to pursue these actions under Section 1107 of the Code, but no such comparable express authority is granted to unsecured creditors' committees when the debtor in possession fails or refuses to pursue valid causes of action. In some courts, this lack of express authority has been held to preclude the committee from taking any action, irrespective of the value to be derived from pursuing such action to the creditor body or, perhaps more important, even where the debtor in possession has no just excuse for refusing to act.

In a number of instances, debtors in possession refuse or fail to act because it would require them to sue their principals, officers, directors, and affiliates to seek to seek recovery of assets improperly transferred to them prior to or on the eve of bankruptcy.

The CLLA does not urge granting sweeping changes to the powers of the committee. Rather, Section 1103(c) should simply be amended in a manner consistent with those courts permitting committee action in the face of the debtor in possession's unjustifiable failure to act in the estate's best interests.

Preferences

1. The *DePrizio* Problem

Despite the clear intent of Congress as expressed in The Bankruptcy Reform Act of 1994 to reject and eliminate the *DePrizio* doctrine, it nevertheless continues to find life in the courts. This issue, which arose primarily from the holding in *Levit v. Ingersoll Rand Financial Corp. (In re V.N. DePrizio Construction Co.)*, 874 F.2d 1186 (7^{th} Cir. 1989), was well articulated by Congress:

> Several recent court decisions have allowed trustees to recapture [preferential] payments made to non-insider creditors a full year prior to the bankruptcy filing, if an insider benefits from the transfer in some way. Although the creditor is not an insider in these cases, the courts have reasoned that because the repayment benefited a corporate insider (namely the officer who signed the guarantee) the non-insider transferee should be liable for returning the transfer to the bankrupt estate as if it were an insider as well.

140 Cong. Rec. H. 10,767 (October 4, 1994) (citations omitted).

In 1994, the intent of Congress was clear: "This section [202 of Pub. L. No. 103-394] overrules the *DePrizio* line of cases and clarifies that non-insider transferees should not be subject to the preference provisions of the Bankruptcy Code beyond the 90-day statutory period." *Id.*

The effect of the 1994 amendment, however, has differed markedly from this stated intent, largely because at that time Congress did not amend Section 547, which actually governs preferences. Instead, Congress only amended Section 550 to preclude trustees from recovering avoided transfers from the non-insider parties. Courts have subsequently distinguished avoidance under Section 547 from recovery under Section 550, thereby allowing the *DePrizio* holding to have continued effect. That is, secured creditors' liens are subject to avoidance under the one-year lookback period under Section 547 if an insider is benefited. That the trustee cannot recover from the creditor is of no significance because once the lien is avoided, the newly unencumbered property can be sold. *See e.g., Roost v. Associates Home Equity Servs., Inc. (In re Williams)* 234 B.R. 801 (Bankr. D. Or. 1999). This interpretation clearly creates results unintended by Congress when it amended the Code in 1994.

Suggested language to properly eliminate the *DePrizio* problem is attached hereto as Exhibit 5.

2. "Ordinary Course" Exception

Section 547 of the Code, which governs preferences, provides that payments made in the "ordinary course" are not avoidable. The policy behind this exception, according to the section's legislative history, is to "leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage actions by either the debtor or his creditors during the debtor's slide into bankruptcy."

In practice, however, the Section 547(c)(2) ordinary course exception has led to significant legal uncertainty and increased costs through the development of complicated standards that the courts apply on a case by case basis.

According to current case law, Section 547(c)(2)(B), the "subjective test," requires a creditor to show that a voidable payment received was ordinary in relation to prior dealings between the creditor and the debtor. Under Section 547(b)(2)(C), the "objective test," a creditor must show that the payment received was not "unusual" within relevant industry norms. Evaluating relevant industry norms requires courts to consider typical payment intervals in the creditor's industry, an often costly and time consuming process.

Adding another layer to the ordinary course analysis, courts have found that the degree to which a creditor will be permitted to deviate from relevant industry norms is directly related to the length of the debtor's and creditor's pre-insolvency relationship. Clearly, theses complex and cumbersome standards produce legal uncertainty in the application of the ordinary course exception.

The CLLA recommends amending Section 547(c)(2) to create an objective standard. Suggested language is attached hereto as Exhibit 5. If adopted, this recommendation would substantially decrease the legal uncertainty that pervades current case law involving the ordinary course exception and would make preference litigation more efficient and more predictable. It would reduce the number of preference suits filed and encourage the settlement of claims. Additionally, the CLLA's recommendation would give debtors and trustees a greater ability to distinguish between valid versus marginal claims, which would presumably reduce the latter category of cases. Thus, administrative costs relating to preference suits would be diminished, leaving more assets available for distribution.

Transfers Made by Nonprofit Charitable Corporations

The CLLA opposes limitations on transfers made by nonprofit charitable organizations because they would significantly impact cases involving hospitals and other nonprofit organizations. Such a limitation would be particularly devastating in the health care arena because a majority of the health care facilities are nonprofit charitable corporations. If viable alternatives to reorganizing calling for the transfer of assets from a nonprofit health care facility to a profit entity are no longer possible, the harm is not limited to creditors, but extends to patients who could be left in limbo. The existing but troubled nonprofit may be equally unable to provide the requisite care or effectively transfer assets to a for-profit corporation that might be better able to use those assets to continue providing the medical care needed by the patients. If the health care facility is unable to reorganize and must cease operating and close its doors, where are the patients in the facilities going to be sent and how will they then be cared for? The community interest in providing care for the patients surely is not furthered by this provision.

The CLLA recognizes that Congress has considered restricting transfers by nonprofit charitable corporations. Accordingly, if such a provision is adopted, several technical corrections should be considered. *See* attached Exhibit 6 for suggested corrective language.

Consumer Bankruptcy

1. Homestead Exemption

A cap on the homestead exemption combined with a prohibition on state opt-out is clearly in order. Limiting the homestead exemption would eliminate forum shopping and the attendant bankruptcy homestead planning affluent debtors have practiced in recent years. In addition, a cap on the homestead exemption would also bring uniformity to the bankruptcy laws across the United States. Without an express prohibition on a state opt out, however, the abusive practice of forum shopping and attendant bankruptcy homestead planning by the affluent may continue unaffected.

2. Anti-Strip Down Amendments

The predominant purpose of consumer bankruptcy reform – to divert greater numbers of consumer debtors into chapter 13 through mandatory means testing – is severely undercut by provisions affecting the valuation of collateral.

Lien-stripping must be preserved in Chapter 13. As a matter of fundamental fairness, loans should be bifurcated into their secured and unsecured portions, and no creditor should be able to collect 100 percent of the unsecured portion of its debt simply because that debt is also partially secured. Proposals to eliminate lien-stripping are in direct contradiction of the stated purpose for bankruptcy reform, that is, greater repayment to unsecured creditors. Losses to unsecured creditors from passage of this proposal have been estimated to approach $100 million annually.

Whether viewed from the perspective of current law or the stated intention of the proposed legislation, this provision significantly reduces the incentive to attempt repayment pursuant to a chapter 13 plan because the debtor's surrender of the collateral will be necessary in a greater number of cases. Moreover, this change diverts value from unsecured creditors in favor of undersecured creditors, again running contrary to the stated intention of the proposed legislation and undercutting the proposed means testing. The 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 and ultimately harms both debtors and their unsecured creditors.

Conclusion

The CLLA appreciates this opportunity to set forth and discuss these significant concerns regarding proposed bankruptcy reform. The CLLA is committed to working with members of the United States House of Representatives and the United States Senate to achieve effective and meaningful bankruptcy reform legislation.

Respectfully submitted,

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EXHIBIT 1

SEC. ______. LOCAL FILING OF BANKRUPTCY CASES.

Section 1408 of title 28, United States Code, is amended –

(1) by striking "Except" and inserting "(a) Except"; and

(2) by adding at the end the following:

"(b) For the purposes of subsection (a), if the debtor is a corporation, the domicile and residence of the debtor are conclusively presumed to be where the debtor's principal place of business in the United States is located."

EXHIBIT 2

SEC. ______. EXECUTORY CONTRACTS AND UNEXPIRED LEASES.

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; or
>
> (B) dismissal of the case."

EXHIBIT 3

SEC. ______. PERMITTING ASSUMPTION OF CONTRACTS.

(a) Section 365(c) of title 11, United States Code, is amended to read:

"(c)(1) The trustee may not assume or assign an executory contract or unexpired lease of the debtor, whether or not the contract or lease prohibits or restricts assignment of rights or delegation of duties, if:

"(A)(i) applicable law excuses a party to the contract or lease from accepting performance from or rendering performance to an assignee of the contract or lease, whether or not the contract or lease prohibits or restricts assignment of rights or delegation of duties; and

"(ii) the party does not consent to the assumption or assignment; or

"(B) the contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor.

"(2) Notwithstanding paragraph (1)(A) of this subsection and applicable nonbankruptcy law, in a case under chapter 11 of this title, a debtor in possession or a trustee for a debtor that is a corporation may assume an executory contract or unexpired lease of the debtor, whether or not the contract or lease prohibits or restricts assignment of rights or delegation of duties.

"(3) The trustee may not assume or assign an unexpired lease of the debtor of nonresidential real property, whether or not the contract or lease prohibits or restricts assignment of rights or delegation of duties, if:

"(A) the lease has been terminated under applicable nonbankruptcy law before the order for relief; or

"(B) the debtor is the lessee under the lease of an aircraft terminal or aircraft gate at an airport at which the debtor is the lessee under one or more additional leases of an aircraft terminal or aircraft gate and the trustee, in connection with the assumption or assignment, does not assume all such leases or does not assume and assign all of such leases to the same person, except that the trustee may assume or assign less than all of such leases with the airport operator's written consent."

(b) Section 365(e) of title 11, United States Code, is amended to read:

"(e)(1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on:

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

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

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

"(2) Paragraph (1) of this subsection does not apply to an executory contract or unexpired lease of the debtor to the extent that the trustee may not assume or assign, and the debtor in possession may not assume, the contract or lease by reason of the provisions of subsection (c) of this section."

EXHIBIT 4

SEC.______. DEFAULTS BASED ON NONMONETARY OBLIGATIONS.

(a) EXECUTORY CONTRACTS AND UNEXPIRED LEASES. – Section 365 of title 11, United States Code, is amended –

(1) in subsection (b) –

(A) in paragraph (1)(A) by striking the semicolon at the end and inserting the following:

"other than a default that is a breach of a provision relating to –

"(i) the satisfaction of any provision (other than a penalty rate or penalty provision) relating to a default arising from any failure to perform nonmonetary obligations under an unexpired lease of real property, if it is impossible for the trustee to cure such default by performing nonmonetary acts at and after the time of assumption; or

"(ii) the satisfaction of any provision (other than a penalty rate or penalty provision) relating to a default arising from any failure to perform nonmonetary obligations under an 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 if the court determines, based on the equities of the case, that this subparagraph should not apply with respect to such default;", and

(B) by amending paragraph (2)(D) to read as follows:

"(D) the satisfaction of any 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.",

(2) in subsection (c) –

(A) in paragraph (2) by adding "or" at the end,

(B) in paragraph (3) by striking "; or" at the end and inserting a period, and

(C) by striking paragraph (4),

(3) in subsection (d) –

(A) by striking paragraphs (5) through (9), and

(B) by redesignating paragraph (10) as paragraph (5).

(4) in subsection (f)(1) by striking "; except that" and all that follows through the end of the paragraph and inserting a period.

(b) Impairment of Claims or Interests. – Section 1124(2) of title 11, United States Code, is amended –

(1) in subparagraph (A) by inserting "or of a kind that section 365(b)(1)(A) of this title expressly does not require to be cured" before the semicolon at the end,

(2) in subparagraph (C) by striking "and" at the end,

(3) by redesignating subparagraph (D) as subparagraph (E), and

(4) by inserting after subparagraph (C) the following:

"(D) if such claim or such interest arises from any failure to perform a nonmonetary obligation, compensates the holder of such claim or such interest (other than the debtor or an insider) for any actual pecuniary loss incurred by such holder as a result of such failure; and".

EXHIBIT 5

SEC. ______. PREFERENCES.

(a) IN GENERAL. – Section 547 of title 11, United States Code, is amended –

(1) in subsection (b), by striking "subsection (c)" and inserting "subsections (e) and (i)"; and

(2) by adding at the end the following:

"(i) If the trustee avoids under subsection (b) a transfer made between 90 days and 1 year before the date of the filing of the petition, by the debtor to an entity that is not an insider for the benefit of a creditor that is an insider, such transfer may be avoided under this section only with respect to the creditor that is an insider."

(b) Paragraph 2 of subsection (c) is amended to read as follows:

"(2) to the extent that such transfer was –

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferr;

(B) (i) made not more than 90 days after the payment was originally due based on a writing agreed to by the debtor and the transferee; or

(ii) if no such writing relating to the due date of the payment exists, made not more than 120 days from the delivery of goods, provision of services or extension of credit upon which the transfer was made; and

(C) not made subsequent to the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor to recover such debt."

(c) APPLICABILITY. – The amendments made by this section shall apply to any case that is pending or commenced on or after the date of the enactment of this Act.

EXHIBIT 6

SEC. ______. TRANSFERS MADE BY NONPROFIT CHARITABLE CORPORATIONS.

(a) SALE OF PROPERTY OF ESTATE. – Section 363(d) of title 11, United States Code, is amended –

(1) by striking "only" and all that follows through the end of the subsection and inserting "only –

"(1) if the debtor is a corporation that is not a moneyed, business, or commercial corporation, in accordance with applicable nonbankruptcy law that governs the transfer of property; and

"(2) to the extent not inconsistent with any relief granted under subsection (c), (d), (e), or (f) of subsection 362 of this title."

(b) CONFIRMATION OF PLAN FOR REORGANIZATION. – Section 1129(a) of title 11, United States Code, is amended by adding at the end the following:

"(15) If the debtor is a corporation that is not a moneyed, business, or commercial corporation, all transfers of property under the plan shall be made in accordance with any applicable provisions of nonbankruptcy law that govern the transfer of property."

(c) TRANSFER OF PROPERTY. – Section 363 of title 11, United States Code, is amended by adding at the end the following:

"(p) Notwithstanding any other provision of this title, property that is held by a debtor that is a corporation described in section 501(c)(3) of the Internal Revenue Code of 1986 and exempt from tax under section 501(a) of such Code may be transferred to an entity that is not such a corporation, but only under the same conditions as would apply if the debtor had not filed a case under this title."

(d) APPLICABILITY. – The amendments made by this section shall apply to a case pending under title 11, United States Code, on the date of the enactment of this Act, except that the court shall not confirm a plan under chapter 11 of this title without considering whether this section would substantially affect the rights of a party in interest who first acquired rights with respect to the debtor after the date of the petition.

(e) RULE OF CONSTRUCTION. – Nothing in this section shall be deemed to require the court in which a case under chapter 11 is pending to remand or refer any proceeding, issue, or controversy to any other court or to require the approval of any other court for the transfer of property.

(f) STANDING. – Section 1109 of title 11, United States Code, is amended by adding at the end:

"(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."

EXHIBIT 7

Sample Small Business Bankruptcy Cases

- A marina located on the Jersey Shore had approximately $2 million in debt. Because the business is seasonal (generally April through October), the requirements for filing a plan under the proposed Small Business provisions could act to significantly reduce the potential return. The case was filed in late fall. Having the opportunity to wait until the start of the next season allowed the business to be packaged for sale as a going concern. If the plan had to be filed within 90 days, or even the extended 150 days set forth in the small business provisions of the bills, the business would not have been able to reorganize, and most likely have been liquidated, thereby providing significantly less for a distribution to unsecured creditors.

- A bar/restaurant with about $2 million in debt required a year to be in a position to propose a plan because of pending legal action seeking a declaratory judgment as to whether its insurance company was required to provide a defense to a Dram Shop action brought against it. The ultimate determination of this litigation impacted the ability of the debtor to successfully reorganize.

EXHIBIT 8

Sample Venue Bankruptcy Case

Debtor, an appliance and electronics retailer, filed a voluntary chapter 11 petition in mid-September, 1998, in Delaware. Less than two months later, the Debtor announced that, rather than reorganizing, a liquidation of all assets would take place.

The Debtor's headquarters were located in Columbus, Ohio. Of its 59 stores at the time of filing, more than half were located in Ohio. Another 11 were located in Pennsylvania, and the remainder were in Indiana, New York, West Virginia, Virginia, Tennessee and Kentucky, each of which had between one and five retail outlets.

The Debtor also owned 11 parcels of real estate, three of which were located in the Columbus, Ohio, region. Seven other parcels were scattered throughout Ohio. The only parcel of land owned outside of Ohio was situated in Erie, Pennsylvania, just east of the Ohio border. No land was owned, nor stores operated, in the state of Delaware.

Among the Debtors creditors were an unknown number of consumers, whose claims would be entitled to priority due to the Debtor's failure to deliver goods or the termination of extended warranties purchased by customers. The majority of these consumers likely resided in Ohio, given the proportion of retail outlets located in that state. In addition, approximately one-third of the Debtor's 2,900 employees worked in Ohio, most of those in Columbus.

According to newspaper reports, the Debtor contacted customers awaiting delivery to advise that scheduled delivery dates would be changed and that if the customer could not accept delivery on the assigned date, the merchandise would be forfeited. Others were told they would not receive merchandise for which they paid because stock was not being replenished. Had the Debtor's case been locally filed, these consumers could have appeared before, and been heard by, the court.

Mr. CANNON. We would like to welcome our friend from Michigan Mr. Conyers.

Thank you, Ms. Miller, and, Mr. Wallace, if you would like to proceed, we will give you 5 minutes now.

STATEMENT OF GEORGE WALLACE, ESQUIRE, OF COUNSEL, ECKERT SEAMANS CHERIN & MELLOT, LLC, WASHINGTON, DC, ON BEHALF OF THE COALITION FOR RESPONSIBLE BANKRUPTCY LAWS

Mr. WALLACE. Thank you, Chairman Cannon, Congressman Watt, Members of the Committee. Thank you for this opportunity to express my views on consumer bankruptcy in H.R. 975. My name is George Wallace. I think you are familiar with me. I speak today on behalf of the Coalition for Responsible Bankruptcies, 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 supports H.R. 975 because it will take significant steps toward reforming today's consumer bankruptcy laws. Those laws are fundamentally flawed, and the need for reform is urgent. Today over 1.5 million or 1.6 million consumer debtors file for bankruptcy relief every year. That rate of filing has more than doubled over the last decade and gone up more than six times since the last sweeping revision to our bankruptcy laws occurred in 1978. Some predicted that by the end of 2003, filings could be as high as 1.7 million or more.

There are too many additional Americans each year filing for bankruptcy to permit continued toleration of this fundamentally flawed system. Particularly in this flat economy with higher levels of unemployment than in the past, it is important that consumer bankruptcy relief be reserved for those who need and deserve it. Our economy can ill afford a situation in which bill-paying American consumers and debtors who deserve bankruptcy relief pay higher prices because others have run up large debts and then used bankruptcy irresponsibly and often dishonestly. The consumer bankruptcy system continues to reward those who lie under oath about their income and expenses and assets. Despite laudable new efforts by the United States Trustee Program, bankruptcy continues to allow debtors and unfortunately sometimes their counsel to abuse the system.

In many places even when a debtor fully discloses that he or she has the ability to repay a significant portion of unsecured debts, a full discharge is granted, no questions asked. The amounts involved are huge. We estimate that each year over $44 billion of debt is discharged in consumer bankruptcy cases. These losses are recovered in the price American consumers pay for credit, an average of $400 for each American household as an estimate. We also estimate that upwards of 4- through 5 billion of those losses could be saved by the means test reforms in the bill. Yet without legislative intervention this year, the situation can only worsen. As more Americans recognize that their neighbors are using bankruptcy, they, too, are tempted to file bankruptcy and take the easy way out. Corruption and abuse breeds more corruption and abuse.

At the same time, it is important to remember that this legislation is clearly the result of extensive bipartisan compromise over more than 6 years. Reform legislation was originally introduced in the 105th Congress and then in the 106th Congress and then in the 107th Congress. In each Congress extensive revisions were made both in Committee and in conference. The bill has significantly changed. The bill before you today improves controls on abuse of bankruptcy law by preserving all that is best about our current bankruptcy system. Honest debtors can obtain bankruptcy relief no matter what their income, expenses or assets as long as they honestly disclose the economic facts about their economic situation.

The improvements to bankruptcy law in H.R. 975 are badly needed, and we support this legislation because of these provisions. Most importantly the bill takes steps to require responsible use of bankruptcy's broad, sweeping remedies. In general the bill provides that if a debtor's case is abusive, the court is to dismiss the debtor's case to obtain bankruptcy relief. This flexible general standard will be applied in a wide range of cases as demanded to thwart the ingenuity of those who would wrongfully or fraudulently try to use the bankruptcy system.

To assist enforcement of this general standard, the bill's most widely recognized innovation, the means test, creates a presumption that the Chapter 7 bankruptcy cases of debtors with incomes over the State median will be dismissed if they can afford to repay a significant part of those debts over a period of 3 to 5 years based on monthly budgets set under court supervision. We expect this innovation alone to provide those responsible to enforce the honesty of the bankruptcy program with significant new tools to carry out their duties.

Significantly the bill also aids the United States Trustee Program in its enforcement efforts, increases funding for that program significantly, provides for more information about debtors' affairs to be provided and checks up on that information with a program of audits.

Some of the most important provisions of the bill significantly also improve the position of women and children who are dependent upon child support, alimony and marital property settlements to receive the money they are entitled to. Today consumer bankruptcy can be used to delay or evade those important family obligations. The bill closes the loopholes the unscrupulous seek to use to delay or evade paying child support or alimony.

Balanced reform is needed to put our consumer bankruptcy laws back on track. After years of negotiation and compromise, this bill has found a middle ground. We urge you to support it.

Thank you very much, Mr. Chairman, and Members of the Committee. I will be glad to answer questions later on.

Mr. CANNON. We congratulate you, Mr. Wallace, for ending exactly on time.

Mr. WALLACE. Sometimes you do it enough times, and you get it right.

Mr. CANNON. Thank you.

[The prepared statement of Mr. Wallace follows:]

PREPARED STATEMENT OF GEORGE J. WALLACE

Chairman Cannon, Congressman Watt and Members of the Committee, thank you for this opportunity to express my views on consumer bankruptcy and H.R. 975, The Bankruptcy Abuse Prevention and Consumer Protection Act of 2003.

My name is George Wallace. I am a lawyer practicing in Washington, D.C., and have been associated with efforts to reform our bankruptcy laws since the 105th Congress, when a reform bill was first introduced.

I speak today on behalf of The Coalition for Responsible Bankruptcy Laws, 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 supports H.R. 975 because it will take significant steps toward reforming today's consumer bankruptcy laws. Those laws are fundamentally flawed and the need for reform is urgent. Today, over 1.5 million consumer debtors file for bankruptcy relief. That rate of filing has more than doubled over the last decade, and gone up more than six times since the last sweeping revision to our bankruptcy laws occurred in 1978. Some predict that by end of 2003, filings could be as high as 1.7 million.

There are too many additional Americans each year filing for bankruptcy to permit continued toleration of this fundamentally flawed system. Particularly in this flat economy with higher levels of unemployment than in the past, it is important that consumer bankruptcy relief be reserved to those who need and deserve it. Our economy can ill afford a situation in which bill paying American consumers and debtors who deserve bankruptcy relief pay higher prices because others have run up large debts, and then used bankruptcy irresponsibly and often dishonestly. The consumer bankruptcy system continues to reward those who lie, under oath, about their income and expenses and their assets. Despite laudable new efforts from the United States Trustee program, bankruptcy continues to allow debtors—and unfortunately, sometimes, their counsel—to abuse the system. In many places, even when a debtor fully discloses that he or she has ability to repay a significant portion of unsecured debts, a full discharge is granted, no questions asked.

The amounts involved are huge. We estimate that each year over $44 billion of debt is discharged in consumer bankruptcy cases. These losses are recovered in the price American consumers pay for credit, an average of $400 for each American household. We also estimate that upwards of $4 through 5 billion of these losses could be saved with the means test reforms in the bill.[1] Yet without legislative intervention this year, the situation can only worsen. As more Americans recognize that their neighbors are using bankruptcy, they too are tempted to file bankruptcy and take the easy way out. Corruption and abuse breeds more corruption and abuse.

At the same time, it is important to remember that this legislation is clearly the result of extensive bipartisan compromise over more than six years. Reform legislation was originally introduced in the 105th Congress. After extensive compromise and revision, the bill sponsored by Congressmen Gekas, Boucher and many others cleared Conference Committee and passed the House with over 300 votes, but it ran out of time in the Senate.

At the beginning of the 106th Congress, Congressman Gekas reintroduced as H.R. 833 the Conference Report from the 105th Congress. H.R. 833 was extensively amended in Committee and on the floor. It eventually passed the House with a large bipartisan majority. On the Senate side, Senator Grassley introduced a version of the Conference Report as S. 625. Likewise after extensive amendment, the Senate passed its bill with extremely strong bipartisan support. H.R. 833 and S. 625, however, had significant differences. After extensive compromises between House and Senate negotiated from February until the end of July, 2000, a compromise bill was worked out which became H.R. 2415 in the last days of the 106th Congress. It passed the House by voice vote and the Senate with a veto-proof majority. However, President Clinton pocket vetoed the legislation and the 106th Congress ended without enactment.

In the 107th Congress, the bill was reintroduced in essentially the form it had passed both houses. As H.R. 333, it passed the House early in the Session without significant changes. A companion bill, S. 420, passed the Senate shortly thereafter with the addition of a substantial number of amendments. Among other changes, the means test of section 102 was significantly altered, a cap was placed on the

[1] Estimates on the number of debtors with ability to pay who obtain Chapter 7 relief and the amount they could have paid ranges from a low of 30,000 debtors a year and approximately $1.2 billion per year based on a study by the debtor oriented American Bankruptcy Institute to approximately 100,000 per year and nearly $4–5 billion based on studies by Ernst & Young.

homestead exemption, and the discharge of debts arising from liability for obstruction of access to those selling lawful goods or services, popularly known as the "Schumer amendment" was added. Assembling the Conference and working out differences took much of the rest of the Session. The Conference Report issued in July of 2002 contained a number of compromises, including a homestead provision that significantly reforms this area of bankruptcy law and a version of the Schumer amendment.

The bill before you today is the Conference Report compromise from the 106th Congress without the Schumer amendment. The bill improves controls on abusive use of bankruptcy law while preserving all that is best about our present bankruptcy system. Honest debtors can obtain bankruptcy relief no matter what their income, expenses, or assets, as long as they honestly disclose the economic facts about their situation. The bill also imposes extensive additional disclosures and regulation on the consumer credit industry. For example, the bill makes major changes to the credit card disclosure rules under the Truth in Lending Act, requiring extensive new disclosures on credit card solicitations and monthly statements. It also creates extensive, new regulation for reaffirmation agreements. This additional regulation will not come cheap to the American consumer. Creditor experience complying with a California law which has similar credit card solicitation provisions indicates that the additional compliance cost will be significant—costs passed on to consumers in higher credit prices.

Whatever doubts we may have about whether the additional regulation of the credit industry will bring commensurate benefits to American consumers, we are confident that the improvements to consumer bankruptcy law are badly needed, and we support this legislation because of these provisions. Most importantly, the bill takes steps to require responsible use of bankruptcy's broad sweeping remedies. In general, the bill provides that if a debtor's case is abusive, the court is to dismiss the debtor's effort to obtain bankruptcy relief. This flexible general standard will be applied in a wide range of cases as demanded to thwart the ingenuity of those who would wrongfully or fraudulently try to use the bankruptcy system. To assist enforcement of this general standard, the bill's most widely recognized innovation, the means test, creates a presumption that the Chapter 7 bankruptcy cases of debtors with incomes over the State median will be dismissed if they can afford to repay a significant part of those debts over a period of 3 to 5 years, based on a monthly budget set under court supervision. We expect this innovation, alone, to provide those responsible to enforce the honesty of the bankruptcy program with significant new tools to carry out their duties. Significantly, the bill aids the United States Trustee program in its enforcement efforts, increases funding for that program significantly, provides for more information about debtor's affairs to be provided in each case, and checks up on that information with a program of audits.

Some of the most important provisions of the bill significantly improve the position of women and children who are dependent upon child support, alimony, and marital property settlements to receive the money they are entitled to. Today, consumer bankruptcy can be used to delay or evade these important family obligations. The bill closes the loopholes the unscrupulous seek to use to delay or evade paying child support or alimony.

At a time when the States are increasingly pressed for revenue, the bill includes major provisions to improve and streamline the collection of state taxes. It also includes the homestead exemption compromise worked out in Conference in the 107th Congress.

In addition, the bill imposes new forms of consumer protection on both the bankruptcy process and on consumer credit and recognizes the importance of low priced secured credit to Americans by improving the ability of the creditor to either get repaid or get the security back promptly. In an important change we believe will better help debtors having debt difficulty to understand their options, the bill requires every individual debtor to go to a brief consumer credit counseling session either before filing or shortly after filing bankruptcy, and gives debtors who do file for bankruptcy new, informative disclosures about the bankruptcy process, what they can expect from it, and how much and when they are going to have to pay for it.

Of course, there are those who oppose this legislation. As someone has said, a true compromise satisfies no one, and this legislation is clearly the product of hard fought compromise. Many continue to think this legislation does not go far enough. Others claim it goes too far.

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. They do not care if the bankruptcy system remains a place where fraud and abuse are every day events. The American people, on the other hand, recognize all too clearly that bankruptcy is being used by some people to evade their responsibilities. In repeated polls of the public, they respond that bankruptcy reform is needed and necessary to limit bankruptcy to those who need it.

Make no mistake about the point I am making. We support the availability of consumer bankruptcy relief. The bill before you today 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". Nothing in this bill will 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 present bankruptcy system is really two systems.

- There is the system for those who are overburdened with debt and are responsibly using the bankruptcy system. This is the vast majority of bankruptcy users. By our estimates, it is 80% to 90%, although some would suggest that this estimate is too high.
- There is another group which uses the bankruptcy system irresponsibly or fraudulently. These people usually have a great deal of debt. But they also have significant income or assets and use the bankruptcy system to evade their personal responsibilities. We estimate this group to be in the 10% to 20% range of bankruptcy users, although, again, some suggest a higher percentage is in fact the case.

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 you misuse the bankruptcy system? Let me give you a few examples.

- Do you owe $40,000 of unsecured debt but have a comfortably steady income so that you could repay it over a few years, perhaps with the help of credit counseling? You can file for chapter 7 relief and discharge that $40,000 *without repaying anything to your creditors*. Enjoy your comfortably steady income.

The legislation addresses this misuse with the "ability to pay" provisions of section 102 as long as the debtor's income is in excess of the State median income level.

- 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. If she does, dismiss the chapter 7 and file a chapter 13. You can discharge property settlement obligations in a chapter 13 proceeding.

This misuse is addressed by making property settlement agreement obligations nondischargeable. No longer will the bankruptcy court be able to undo the results of domestic relations court.

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

The bill stops this abuse. If you incurred debt by fraud, it is not discharged.

- Do you owe significant nondischargeable debts (e.g., fraud or tax debts) 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 nondischargeable debts.

Under the legislation, if you purchased a car on credit within 2 years of filing and go into chapter 13, you have to pay for the car the same way your neighbor has to. The same result occurs if you purchase a large screen TV one year before filing. No longer can you take money from your secured creditor and use it to pay other bills, or in some instances, to cover your own living expenses—while you keep the car.

Each of the examples I have given of what you can do may be 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. 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.

Critics of bankruptcy reform efforts have claimed that the provisions in the legislation aimed at those with ability to pay are excessively harsh on debtors who need and deserve bankruptcy relief. For example, they claim it is an unacceptable burden on those seeking relief to require them to attend a brief credit counseling session in which they will learn how credit counseling might help them. They similarly claim that requiring that debtors receive some brief additional disclosures to explain the bankruptcy process and their relationship with their attorney also imposes an unacceptable burden on obtaining relief. Nothing could be farther from the truth. Exposure to credit counseling before filing bankruptcy can save some debtors from the damage bankruptcy does to their credit rating. It introduces them to budgeting, which experts tell us is often the problem. Other critics urge that the educational features of the program won't work, or are too expensive. To be sure, there are questions about how to best develop an effective program as there always are. But the bill contains flexible standards which give the United States Trustee Program the ability to structure and refine an effective program over time. It also provides for a pilot project which will enable the Program to evaluate and experiment with innovative approaches to carrying out this mission. The need for debtor education and improved financial literacy is great if bankruptcy is to be truly rehabilitative. The catalyst of this legislation has resulted in much constructive work already being done on how to best structure the educational process, and it will continue to have that effect. Given the need, there can be no doubt that the counseling and educational programs included in the bill are worth the effort and cost.

Balanced reform is needed to put our consumer bankruptcy laws back on track. After years of negotiation and compromise, the bill has found a middle ground. We urge you to support it.

In closing, let me stress again the significance of this legislation to close loopholes that today permit debtors to delay or evade child support, alimony and property settlement obligations. I have heard no one who says that these provisions are not strong enough. And they are needed to make sure that these important social responsibilities are not evaded in bankruptcy court. Bankruptcy court should not be a court of second resort after domestic relations court where you can undo your obligations to your children and society.

Thank you for the opportunity to address the Committee.

Mr. CANNON. In deference to your schedule, Mr. Coble, we would like to give you the first opportunity to ask questions.

Mr. COBLE. Thank you, Mr. Chairman. I will be brief.

And the Chairman imposes the red light rule against us as well, folks. I will try to get through in 5 minutes.

Mr. Friedman, what are some examples of how debtors can abuse the present consumer bankruptcy system?

Mr. FRIEDMAN. Congressman, there are a number of areas which the provisions of this bill will help strengthen and enforce for us. Examples are abuse of serial filings, where people file over and over again to stop a foreclosure on a home, and filings where people run up credit cards in what we call credit card bustout scams, and they therefore run up the credit cards, pay the credit cards down with insufficient funds. The minute that the funds are posted to the account, they would then max out the credit cards again and thus break out—double the limit on their credit cards and abuse the bankruptcy system. These are just a couple of the examples of abuse in the system.

Mr. COBLE. Thank you, sir.

Has section 707(b) been a success or a failure? If you can say one or the other?

Mr. FRIEDMAN. I would say section 707(b) has been a tool that we have used so far, but it will be enhanced by the provisions of this bill such that it will set forth a uniform standard that can be applied consistently throughout the United States, and that strength is needed.

Mr. COBLE. Thank you, sir.

Ms. Miller, now, your organization purports to represent a creditor's perspective, but yet Mr. Wallace's organization, the Coalition for Responsible Bankruptcy Laws, U.S. Chamber of Commerce, the Financial Services Roundtable, the National Association of Credit Managers, the National Retailers Federation, the Bond Market Association, et cetera, they are some of this legislation's most avid supporters. You are on the other side of that. Both of you, you and these groups I just mentioned, purportedly speak for creditors. And I realize reasonable people can disagree, but illuminate on that for me.

Ms. MILLER. Let me suggest there are a number—the Commercial Law League of America is not the only organization that has opposed the legislation because it doesn't protect creditors' rights. Every major bankruptcy organization that has honed in on—has been criticizing this legislation since it was first enacted, number one.

Number two, a number of the provisions in the bill ultimately deprive unsecured creditors of maximizing a distribution from the estate. One of those provisions that I alluded to is the lien-stripping provision. While Mr. Wallace and I may disagree on the overall perspective of what the bill does, I don't think anybody has contended that unsecured creditors aren't going to suffer if the lien-stripping provision is enacted. Why should secured creditors be treated any differently as a result of the filing of the bankruptcy than they would be treated outside of bankruptcy? Why should unsecured creditors not receive a distribution from the estate?

Mr. COBLE. Well, bankruptcy organizations ofttimes include debtors' attorneys. Would that be perhaps one reason why the disparity in the other groups I mentioned?

Ms. MILLER. The Commercial Law League represents both debtor interests and creditor interests, but we have always pushed forward for fair and balanced legislation. We are primarily a creditors' rights organization, and having looked at the bill and analyzed it over the last 6 years, it simply doesn't protect the interests of the general unsecured creditors.

Mr. COBLE. Ms. Beckwith, if you or Mr. Wallace want to weigh in before my time runs out, either of you.

Mr. WALLACE. I would say the Commercial Law League is an association of attorneys who refer business amongst one another. It is an old organization. I think that they are concerned about protecting how they make their money. They have made their money in bankruptcy for a number of years, and they are concerned about continuing to do that. I understand that they have general interests and that they are well-intentioned, but I think in this interest they are somewhat deflected from those concerns and focusing more upon how the system now works for them rather than how it should work for all of us.

Mr. COBLE. Thank you, sir.

Mr. Chairman, thank you for letting me do the—I will go back and forth to my meeting and hopefully will return.

Mr. CANNON. Thank you, Mr. Coble.

The Chair now recognizes Mr. Watt for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman.

Mr. Friedman, if a person falls below the means test in this bill, will there be any substantial changes to that person's processing of his bankruptcy?

Mr. FRIEDMAN. I don't believe there would be any substantial change in the processing, because the provisions of the means test with regard to qualification only kick in above a certain level, which I believe is the median level.

Mr. WATT. So if people fall below the means test and are abusing the system now, they will continue to have the same rules apply to them, and they cannot continue to abuse the system?

Mr. FRIEDMAN. No. I wouldn't say that. I——

Mr. WATT. Is there anything in this bill that will make circumstances different for somebody who falls below the means test?

Mr. FRIEDMAN. The income portion of the means test. But the change that this bill makes to that section of the Code also has a provision for people who otherwise abuse the system, and we currently look at those people. We would continue to look at those people with regard to the abuses in the system they may have.

Mr. WATT. So bankruptcy judges and trustees then will continue to have some discretion, same kind of discretion they have under the current system; is what you are saying?

Mr. FRIEDMAN. What I am saying is that the current system has a standard which is not as uniformly applicable as I believe the enhancements would be under this legislation.

Mr. WATT. Ms. Beckwith—well, let me just go back to Mr. Friedman for a second. Are you at all concerned that this whole means test approach creates two categories of bankruptcy courts in the country now if this bill passes, or is that not a concern to you?

Mr. FRIEDMAN. Congressman, the means test as written in the current legislation provides an additional tool for identifying——

Mr. WATT. Can you answer yes or no and then explain? Are you concerned that after this bill passes, if it passes in its current form, there will, in effect, be two different bankruptcy courts?

Mr. FRIEDMAN. No.

Mr. WATT. All right. Ms. Beckwith, you testified that 256,000 credit union members in 2002——

Ms. BECKWITH. Yes, sir.

Mr. WATT [continuing]. Filed bankruptcy?

Ms. BECKWITH. Yes, sir.

Mr. WATT. Has CUNA or the credit union association done any analysis to determine what percentage of those 256,000 people fall above the means test and what percentage falls below the means test?

Ms. BECKWITH. Not to my knowledge, sir.

Mr. WATT. So if there is no substantial difference in the way their bankruptcies are processed for people who fall below the means test, you don't think that would be a relevant consideration in your evaluation of this bill?

Ms. BECKWITH. Sir, I think it will protect those who fall below the means test. If I did not feel that way, I would not support this bill. It is important that the people who have a real crisis in their life are protected.

Mr. WATT. The credit card example that you talked about in your testimony, is there anything in this bill or otherwise that would impose upon lenders any additional responsibilities to assure that this couple that you described that was going around just taking the credit line—had any greater responsibility in evaluating whether a borrower was doing that?

Ms. BECKWITH. Sir, at the time we extended the credit to these two members, there was no way we could legally deny them credit. You know, they met all of the credit tests.

Mr. WATT. I am saying—and I don't like to refer to people in my family or myself, but I consistently get credit card offers extending substantial credit. Are other people applying the same type of criteria that you are applying?

Ms. BECKWITH. Sir, I believe the educational opportunities in this bill over time will educate the people of this Nation to where they will be able to handle their financial obligations better and be less apt to fall into that trap.

Mr. WATT. Thank you, Mr. Chairman.

Mr. CANNON. Thank you, Mr. Watt.

Mr. Chabot, would you like to take 5 minutes?

Mr. CHABOT. Yes. Thank you, Mr. Chairman.

We have been through this issue so many times before, I don't know if I will take the full 5 minutes. It has been a long road, and I sympathize with many of the panel members and many of the folks that are here today who have been fighting this battle for such a long time. I am cautiously optimistic that we will be successful this time. I hope that we don't get sidetracked by issues which are only marginally related to abortion and probably shouldn't have been brought up in the first place, but hopefully we can get it done this time.

And whenever I think about this issue, I think about how the American people literally are paying more for products because some of their fellow citizens aren't living up to their obligations, and bankruptcy should be there for people who really need it, for people who have sustained a particular trauma in their family. Perhaps there has been a loss of job or even a death in the family sometimes, or pretty substantial medical bills. I mean, there are people who legitimately need to file bankruptcy, but unfortunately, some of our fellow citizens have found a way to scam the system and run up credit cards and basically leave the rest of us holding the bag. And hopefully—I mean, this bill will not eliminate that completely, but it will certainly be a step in the right direction, and that is why I think it would be good for the country, good for the economy, good for personal responsibility if we can get the job done this time. And I hope that we are successful.

Just a couple of questions. What are the most common ways—what are the—Ms. Beckwith, you mentioned the Hawaiian wedding and the $20,000 as I think a particularly egregious example of somebody scamming the system. I mean, that is certainly not what bankruptcy was intended to be used for, but if you are—Mr. Wallace or Ms. Beckwith or any of the panel members would like to give us any other examples of things that they have seen happen or particular ways that people do avoid their debts and use bankruptcy in a way that it was not intended to be used. So I would be happy to hear from any of the panel members.

Ms. BECKWITH. Sir, a lot of times people—you can look at their credit reports and you can see where they have loaded up at furniture stores and things, and then you look at the credit report, and then you notice where they got a mortgage about a year earlier. They have decorated their house at the expense of my other members.

At other times we have seen people—when we looked at their credit reports—who have taken expensive vacations and this sort of stuff and then again file bankruptcy.

There was a credit union in Minnesota who had a $30,000 loss. This is in my written testimony. And they received his—he moved to Florida, and his hometown paper received an article with a picture of him in front of his new power boat talking about his multiple golf memberships and what fun he was having fishing.

And the people of the credit union in that town paid a great loss, you know, I mean it was just that they paid for his retirement, and I think that is wrong. That is abusive.

Mr. CHABOT. Thank you.

Mr. WALLACE. Let me give you two examples of situations that the bill would address and that are important to address. For example, it is—one of the things that bankruptcy can be used for is to get rid of property settlement obligations that arise out of a marital breakup, and you can use chapter 7 and a combination of chapter 7 and chapter 13 to get rid of those obligations today. It is a combination of substantive and procedural laws the way you do it. There is even a book that shows you how to do that. That is one of the examples of the kinds of things that would be blocked by this bill. Marital property provisions of the bill block that.

The second way is that if you have committed fraud today and become liable for debt, there is a way in which you can use chapter 13 today to discharge the fraudulent debt, the debt that arises from fraud, and that is also blocked by the bill.

These are important changes. There is one other thing I wanted to mention in terms of what Congressman Watt was mentioning before. The standard for the 707(b) today is substantial abuse. You have to prove that there is substantial abuse and there is a presumption that the debtor has not abused. However, under the bill the standard is changed to abuse. You have to prove that the debtor has engaged in abuse, which is a lower standard, and the presumption in favor of the debtor is taken away. This will enable the United States Trustee's Office and trustees to handle the cases that Congressman Watt was raising, which I would agree are abusive and need to be dealt with in the situation where the debtor is below the median income.

Ms. MILLER. I would also like to make a comment, Congressman Chabot, and also to respond to something that Congressman Watt indicated.

Mr. CHABOT. It is actually pronounced "Chabot."

Ms. MILLER. I am sorry. I apologize.

Mr. CHABOT. As long as you don't use the French pronunciation, "Chabot."

Mr. CANNON. Wait a minute, Steve. We don't call you "Chabot" anymore? I might just remind the witness that the time has run, but if you would like to finish up your answer.

Ms. MILLER. Thank you very much. While there are educational provisions that are geared at educating debtors in terms of securing credit and incurring financial obligations under the bill, there are no equivalent provisions with regard to policing the manner in which credit cards are issued or credit card applications arrive at people's homes. I can't tell you personally how many I have received, or how many my minor children received.

In fact, one of my colleagues that is a member of the Commercial Law League got a new dog and the dog—he applied for a dog tag for the dog. And lo and behold, after the dog tag arrived, a credit card application arrived for the dog. Was the dog going to put his paw on it?

Mr. CANNON. Mr. Nadler, I think you are next.

Mr. NADLER. Thank you, Mr. Chairman. Let me say first to Mr. Friedman, I would request that if you haven't done so, would you prepare a section-by-section analysis and give it to the Committee of all the new duties that the U.S. Trustees and the private trustees will have if this bill passes and itemize the cost of each new function, such as audit, storage of additional paperwork and additional notices?

I am especially interested in the section 102(c) of the bill which requires the U.S. Trustee to do a lot of things. I think we would be very interested in seeing exactly what new public costs this bill imposes in this time of fiscal stringency, great tax cuts and no provision for any public expenditure. So I would be interested in your analysis if you could get that to the Committee after today.

Thank you.

Ms. Beckwith, the one provision we have been told in negotiations is the deal breaker for the credit unions and you mentioned this, as one of the three requirements, is the title and reaffirmation agreements. The bill provides that the court may reject a reaffirmation agreement if it would cause undue hardship, which is astonishingly defined in the bill as requiring payments in excess of the debtor's disposable income. Even more astonishingly, credit unions are exempt from this pathetic restriction on reaffirmations.

Can you justify stripping a bankruptcy court of the ability to reject under any circumstances a reaffirmation agreement that would require a debtor to pay more than his total disposable income? Is this really a deal breaker for the credit unions or would you approve of the Committee placing the credit unions under the same rules that in the bill apply to all other creditors seeking reaffirmation?

Ms. BECKWITH. That was a lot of questions.

Mr. NADLER. Well, I will summarize it. Do you really think that credit unions should be exempt from the requirement that a reaffirmation cannot impose the obligation to repay more than total disposable income on the debtor? Yes or no.

Ms. BECKWITH. No, I don't. I don't think the credit union would ask that.

Mr. NADLER. Well, you have asked. So you would be perfectly willing to have the bill amended so that the credit unions would be subject to this provision of the bill as is every other creditor?

Ms. BECKWITH. Sir, it is in the members best interest most of the time that they be able to reaffirm.

Mr. NADLER. That it is not my question. I don't have a lot of time. Please answer my question, not a question I didn't ask. Would be willing to have the bill amended so that credit unions would be subject to the same provision in the bill as every other creditor, that they cannot do a reaffirmation of such a nature that the creditor has to pay—the debtor has to pay back more than his total disposable income?

Ms. BECKWITH. Sir, I would have to have some research done on that and get back to you.

Mr. NADLER. I think that that answer says all I need to say about the honesty of this presentation.

Let me ask Mr. Wallace. This bill imposes substantial costs on the Government to investigate and audit debtors. Why should the public funds be used to do the due diligence for major banks and other creditors when they are unwilling to do the investigation themselves or to seek more substantial information about the borrower before making extension of credit? We know that they are flooding people who don't have an ability to repay a lot of money with credit card applications. And what this bill suggests is that the Government should pay for their due diligence. I assume you are aware that a creditor may examine the debtor at the 341 meeting. So why are—why should the Government assume this—the duty to investigate and audit the debtors? Why isn't this the responsibility of the banks and the credit card issuers before they issue the credit card?

Mr. WALLACE. This is a bank—the bankruptcy is a governmental program, Congressman. And it seems to me that the Government has a responsibility of keeping a governmental program honest. Under some circumstances I guess it is possible for a creditor to participate in a 341 proceeding and they do do so. However, they do not have either the power of the Government nor the sweep of the Government's inquiry in order to try to find out and ferret out all fraud. They are determined by profit and expense.

Mr. NADLER. I understand.

Mr. WALLACE. Whereas what the Government is concerned about is honesty.

Mr. NADLER. Sir, I understand. But are you aware that a creditor has the right under section 343 of the Code, in rule 2004 to conduct an extensive examination under penalty of perjury of the debtor's financial circumstances, including the production of documents?

Mr. WALLACE. Yes, I have done these things and they do take a fair amount of time and I bill my clients for them. They are expensive.

Mr. NADLER. So why should the Government obtain—why should the Government have to spend public money to do the job that the creditors should be doing?

Mr. WALLACE. Because it is a governmental program, sir. Because it is not the job of the creditor. It is the job of the Government, sir, to conduct a fair, honest and clean bankruptcy system.

Mr. NADLER. So you are turning the Government into a credit——

Mr. CANNON. The gentleman's time has expired, but I will do a second round if you would like to do that.

Mr. NADLER. Thank you.

Mr. CANNON. Mr. Delahunt, would you like to take 5 minutes?

Mr. DELAHUNT. Yes. Thank you, Mr. Chairman. I think it was you, Mr. Wallace, and it is good to see you again. I have missed you through the years and it is good to know that you are back. I hope you come back in 2 years.

Mr. WALLACE. I am sure you do and I do not.

Mr. DELAHUNT. You know, Mr. Friedman, you talk about—I mean we heard Mr. Wallace talk about people lying under oath, and you talked about enhanced tools. I mean the reality is the kind of fraud and abuse that you reference is susceptible to criminal investigations. Is that a fair and accurate statement?

Mr. FRIEDMAN. The question was, is it susceptible to criminal prosecution?

Mr. DELAHUNT. Absolutely.

Mr. FRIEDMAN. It is in some cases.

Mr. DELAHUNT. In many cases presumably. In my former career I was a district attorney and you know if, Ms. Beckwith, you would come to my office with that case I would have assigned the matter to my white collar crime fraud squad and they would have been out and hopefully that would have, you know, sent a loud and very clear message and hopefully resulted in some deterrence. But I am really interested in the response by Ms. Miller to Mr. Wallace's suggestion that those lawyers that make up your League are really doing this out of self-interest.

Ms. MILLER. I am glad you asked that question.

Mr. DELAHUNT. I bet you are. Can I just—let me just follow that up. And let's just really get, you know, let's cut to the quick here, so to speak. I understand your major concern is that unsecured creditors are being displaced here. Their chance at getting their fair share is reduced. Am I correct on that?

Ms. MILLER. Absolutely.

Mr. DELAHUNT. Now, I don't hear you singing any great songs of sympathy for debtors. I mean, at least I haven't heard it to date. Now I am sure in your heart of hearts you are concerned about the poor debtor. But can you tell us in very simple terms so that all the Members of the Committee can understand what the import of this bill is in terms of under secured creditors? You referred to the lean stripping provisions. Why didn't you explain to us in very simple terms that we can all understand? Who is making out in this bill? Maybe that is the bottom line. No pun intended.

Ms. MILLER. No, you have asked me a number of questions and I guess I would like to first respond to the fact that somehow because my pockets are being padded that influences my testimony here today. I have been a member of the League since 1993. I have been involved in the academic pursuit of fair and balanced legislation for the League since 1994 and have chaired the League's legislative effort in that regard. I am pleased to report to the Committee that I haven't had any—I don't get referrals from the League. I am involved there because it is a wonderful network for connections and it has been a wonderful opportunity for me to be able to get involved in commenting on the legislation.

So Mr. Wallace's comments really don't bear out the proof, number one. Number two, with regard to the lean stripping, normally the way that the Bankruptcy Code is worded today, under section

506 of the Code, a secured creditor's claim is limited with respect to the secured portion based on the value of its collateral. Therefore, if you have bought a piece of property that at the time was worth $100 and at the time that the bankruptcy was filed the property is only worth $50, the secured creditor has a claim for $50 secured and the deficiency is treated as an unsecured claim. Under the proposed bill it seeks to change that process in the case of car loans that have been outstanding for 2½ years, or with regard to any purchases that have been made within a year of bankruptcy, such that the full amount owed to the secured creditor at that time regardless of the value of the property, is treated as a fully secured claim, even though outside of bankruptcy if there were a default and the secured creditor sought to foreclose under Revised Article 9 of the Uniform Commercial Code it would be limited only to the value of its collateral and the deficiency would still be treated as an unsecured claim.

Mr. DELAHUNT. So who is making out in this? You talked about the car loans. The secured creditors are making out to the disadvantage of unsecured creditors?

Ms. MILLER. Absolutely.

Mr. DELAHUNT. If I could just indulge you for 30 seconds more, Mr. Chairman.

Mr. CANNON. Without objection.

Mr. DELAHUNT. And is there anything in this bill that elevates an unsecured creditor to the status of a secured creditor?

Ms. MILLER. Not that I am aware of. But I might even point out further there are some unsecured creditors. I mean you have to look at some of the special interests that are being taken care of in the bill. For example, if you can indulge me, the real estate lessors currently under section 365 are entitled to get paid currently for all their obligations as they become due. Under the bill it enhances the protections for the real estate lessors such that there is a limited period of time by which the debtor must decide to assume or reject a commercial real estate lease. And at that point if they haven't taken the action the lessor can withhold the right for them to have any additional time. If the debtor makes the wrong decision and either decides wrong, doesn't assume the lease and loses a valuable asset and can't reorganize, ultimately the creditors, the unsecured creditors have lost the option of being able to maximize the going concern value of those assets for the benefit of everybody. On the other hand, if the debtor makes the wrong decision and assumes that lease improvidently and then finds out it really shouldn't have done so, then it has created the huge administrative expense claim for the estate, thereby depriving unsecured creditors of money. As long as the landlord is getting paid currently there is no abuse that needs to be addressed.

Mr. CANNON. Thank you, Ms. Miller. Presumably we have saved the Subcommittee 5 minutes on the second round of questioning, Mr. Delahunt. The Chair recognizes the gentleman from Michigan, Mr. Conyers, if you would like to.

Mr. CONYERS. Thank you, Mr. Chairman. I want to welcome Attorney Miller to these proceedings. I am happy to have her testimony on behalf of the organization, Commercial Law League of America, and I am astounded by the fact that there is a general approval of these witnesses before this Committee, perhaps save one, about means testing, which in our last hearing was determined by some to be arbitrary, unworkable and bureaucratic, that the means testing provisions will harm low income, middle income people, and will have adverse impact on women, children, minorities, seniors as well as victims of crime.

Did any of that, Ms. Beckwith, come to your attention in examining the measure that you support here this afternoon?

Ms. BECKWITH. Sir, I believe that the means testing will help those who indeed have a critical crisis in their life and need to file for bankruptcy, and it also does move up the position of child support and alimony and, you know, pushes down the attorney's fees. So it is going to help in several ways.

Mr. CONYERS. Did you find anything, Ms.—Attorney Miller, about means testing that you might want to reiterate or bring to the Committee's attention this afternoon?

Ms. MILLER. Attached to—a number of position papers have been submitted over the term that the bills have been pending in Congress. The League has been opposed to means testing because it is difficult to apply. It is subject to manipulation. It is not necessarily applied in the standard fashion. It relies on IRS guidelines which are not necessarily easily understood or necessarily were drafted in a way with bankruptcy in mind. It also—depending upon the circumstance in which you are, it sometimes penalizes those that—for instance, that are not paying, that are current with their child support obligations as against those that are not current. It also seems to have differing impacts depending upon whether you own a house versus you lease premises. It just doesn't seem to work. And moreover, as long as the bill has been pending I am not aware of any retrospective analysis of how the means test would have worked or if it would have worked and how much it even would have been applied to. And it seems as though over the number of years that the legislation has been pending at a minimum some kind of studied analysis would be done before we go forward with the proposed means test that has been criticized so significantly.

Mr. CONYERS. Now, Ms. Beckwith, again, please, have you been—your organization been disturbed by the great number of credit cards that leaflet America, everybody and their dog gets one, kids in college, people with no credit, bad credit? Is this a problem that may have come to your attention?

Ms. BECKWITH. Sir, the parts of this bill that deal with member education are very, very important to me. In my own credit union we do not give a college student a credit card above $700 without a parents cosigning with them. We feel it is wrong to do that. But again, education of people is what is important. They have to be financially educated and we are a firm supporter of the NEFE program, which is the National Endowment for Financial Education, and are involved in that in South Carolina to a great degree.

Mr. CONYERS. Gee, I am happy to hear that. I don't know what the college kids are going to do with that education as these credit cards are mailed directly to the university or they are waiting for them at their house. And a lot of adults, not even kids, get caught up in this. Don't you think we got a little bit more of a problem?

Couldn't it be possible that we could get some restraint on the credit card companies?

Ms. BECKWITH. Sir, again, I think it is a matter of personal responsibility and in our credit union we also have a program called Young Trust, which is for members between 16 and 25 years old, where we have special programs for them where they learn about credit. They learn about the loan process and what we actually look at and how important retaining a good credit rating is. They also learn about debt to income ratios and, you know, several other things that we help them with in order to educate them. In America we need more financial education, sir.

Mr. CONYERS. Thank you.

Mr. CANNON. Thank you, Mr. Conyers. Mr. Friedman, Mr. Watt asked you earlier about whether this bill would create two bankruptcy courts and you seem to have had a longer answer which you then gave a one-word response to. Would you like to expand on that for a moment?

Mr. FRIEDMAN. Certainly, Mr. Chairman. The provisions which Congressman Watt were discussing and questioning me about provide a test which is much more focused in ferreting out cases where there is possibly fraud and abuse and in giving us a uniform standard that could be applied coast to coast for determining what is or is not abusive under the Code as opposed to the current legislation that we act under.

Mr. CANNON. Great. Thank you.

Ms. Miller, Mr. Delahunt raised the issue of responding to Mr. Wallace's particular statements and then asked several questions. If you would like to take a few moments to respond with particularity, I would be pleased to have you do that.

Ms. MILLER. I think I had already responded, and quite frankly I was somewhat shocked at his suggestion. The League has repeatedly been asked to appear before Congress as experts on bankruptcy. We have been repeatedly contacted with regard to pending legislation to submit position papers. We have always taken a fair and balanced approach, both with regard to debtors and creditors, because we feel that is imperative in the type of multi-constituent process in which you are involved.

Mr. CANNON. You don't want to deal with the specifics or would you like to deal with those specific statements that you made?

Ms. MILLER. I guess I am—can you redefine to me the specifics that you were——

Mr. CANNON. No. Mr. Wallace, would you like to repeat those?

Mr. WALLACE. Well, what I was pointing out and without any personal animus or anything, I just pointed out that the Commercial Law League is a referral organization. I mean it is part of the bankruptcy establishment. It is concerned principally with the improvement of bankruptcy law for the purposes of its members and its members make money in the bankruptcy system. That is all I suggested.

Ms. MILLER. I think any organization that is here has—that people belong to memberships in order to be able to network and ultimately market who they are and what they do in order to secure business. I think that Mr. Wallace represents a number of people that are interested in pursuing a similar set of goals for their members.

Mr. CANNON. Thank you. You have in fact testified in the past and I—as you were giving your opening statement, you talked about times being different right now. And I am wondering, obviously we have had more bankruptcies, so we are moving up and it is not like we are declining in the number of bankruptcies. Were you trying to express a concern in your opening statement that if we do this bankruptcy bill that we will somehow turn consumers off and that would be bad for the economy?

Ms. MILLER. No. What I was suggesting is that the economy is in a much more serious and fragile condition today than it was when bankruptcy reform was first considered and since the last time that I appeared before this Committee and that there are numerous causes for the increase in bankruptcy, but one cannot necessarily assume it is due to abuse. I think we all know there is some abuse out there and there is fraud out there and that it should be addressed. But the increase alone is not due to abuse and fraud, and that presumption is what is erroneous and in view of the changed economy, being slowed down and all of the repercussions that we haven't begun to see from the large bankruptcies, where there are going to be corporate shutdowns, where people are losing their jobs, how many people do we hear where corporations are downsizing and people are losing their jobs?

Mr. CANNON. Let me just—I only have one more minute. I want to you to flesh this out. But it seems to me that in the past you have testified in favor of harsher provisions than in this bill in this particular. I am just wondering, do you believe that the number of bankruptcies—there are some underlying changes in society that is being masked; in other words, we have an increase in bankruptcies because of short-term problems with the economy instead of a fundamental turnaround in the economy or a turnaround in the bankruptcy understanding and proceedings?

Ms. MILLER. I think that the economy is much more fragile, and as a result Congress has to take pause and really consider what the impact of passing this legislation will be and whether or not it really addresses——

Mr. CANNON. Pardon me. Just so I can do this before—I see the distinction between abuses and a fragile economy. But when you are talking about a fragile economy, are you saying that this Subommittee should defer these rules until the economy is more robust?

Ms. MILLER. I am not necessarily saying that they should defer. I think that they should carefully consider whether or not this is the appropriate vehicle to address bankruptcy reform.

Mr. CANNON. Thank you. We are going to do a second round of questioning. I think that—may I just have an indication of who would like to do a second round? Okay.

Mr. Watt, do you want to then take 5 minutes?

Mr. WATT. Thank you, Mr. Chairman. I want to go back to this issue that Mr. Friedman and now Mr. Wallace has addressed because I still am concerned that we are setting up two separate systems of bankruptcy here and I think that is bad public policy. I confess that I am one of the few people that is out here expressing this concern, but I just think it is very bad public policy.

Now, as I understand where we are now, the standard is abuse, as Mr. Wallace has pointed out to us, is substantial abuse, and under the new bill we are going to abuse being the standard. Is that correct?

Mr. WALLACE. That is correct.

Mr. WATT. But under the existing law judges have the right to determine what is substantial abuse and, as I understand it, under the new law judges will only be able to determine what is abuse for people who fall below the means test. Is that correct?

Mr. WALLACE. I don't think I would agree with that characterization quite. The standard is whether or not there is abuse. If you are above the State median income then there is a presumption that you have abused the system; i.e., that there is abuse.

Mr. WATT. Okay, And if you are below it there is a presumption that you have not?

Mr. WALLACE. No. There is no presumption if you are below. There is just nothing. It is just the standard of abuse.

Mr. WATT. So you are saying that if you are above it you presume that you have; if you are below it there is no presumption at all?

Mr. WALLACE. That is correct.

Mr. WATT. And that is not a presumption that you have not?

Mr. WALLACE. That is correct, sir, yes, because—yes. That is correct. I think that is right. There are a lot of double negatives in that, but I believe that that is correct.

Mr. WATT. And now, Mr. Friedman, you say that the standards for these new standards are going to give you a uniform national standard to apply. That is what you said in response to somebody's question. I can't remember whose it was. But those standards that you are talking about are standards that will be applicable only for people above the means test. Isn't that right?

Mr. FRIEDMAN. I don't believe that that is true, Congressman. What 707(b) in the draft legislation does is set forth objective standards, specific objective standards.

Mr. WATT. For people above the means test?

Mr. FRIEDMAN. It sets forth objective——

Mr. WATT. For people above the means test?

Mr. FRIEDMAN. The only thing that the means test does is set forth objective standards by which the presumption is thought of one way or another. It doesn't mean the people below the means test are not subject to having their case dismissed because they abuse the system and it doesn't mean that those above the means test are subject to having their cases dismissed unilaterally because they were above it. It creates a presumption.

Mr. WATT. And that presumption directs you either into one form of bankruptcy or another form of bankruptcy, is that correct?

Mr. FRIEDMAN. That is not the way I understand the statute. The presumption sets forth a determination, at which point if you were above the presumption the debtor would have the burden if a motion were filed to dismiss the case of substantiating that it is not abuse for them to get the granting of relief. But it is all within the same court and the same context and the same statute.

Mr. WATT. And what happens if you are below the means test?

Mr. FRIEDMAN. Then if someone files a motion to dismiss your case it is upon the burden of the filing party objecting.

Mr. WATT. And who makes that determination of whether there is abuse or not?

Mr. FRIEDMAN. I don't think it is a determination of whether there is an abuse. The application of the standard to the United States Trustee Program would be that the United States Trustee Program perform a certification.

Mr. WATT. So you are saying there is no determination made of whether there is an abuse if you fall below the means test?

Mr. FRIEDMAN. There is only—there are determinations made under the section 707(b). If the median income is above the standard——

Mr. WATT. I am asking about people who fall below the means test. Is there a determination of whether there is abuse or not?

Mr. FRIEDMAN. Well, absolutely. Our program currently——

Mr. WATT. And who make that determination?

Mr. FRIEDMAN. The United States Trustee Program for one reviews a lot of chapter 7 cases.

Mr. WATT. Who has the ultimate responsibility for making the determination?

Mr. FRIEDMAN. Well, the court.

Mr. WATT. The court makes that determination?

Mr. FRIEDMAN. That's right.

Mr. WATT. And they make it without the benefit of any kind of presumption, whereas if you are above the means test there is a set of arbitrary rules that say you have got to overcome this presumption otherwise you go to one court or the—one kind of bankruptcy or another kind of bankruptcy. Isn't that right?

Mr. FRIEDMAN. I wouldn't agree with that characterization, Congressman.

Mr. WATT. Okay.

Mr. CANNON. Thank you.

Mr. Chabot, would you like to take 5 minutes?

Mr. CHABOT. Yes. Thank you, Mr. Chairman.

Mr. Wallace, in light of your prior experience as a faculty advisor for a low income legal clinic, I believe in Iowa it was, what is your response to those who say that these bankruptcy reforms, especially with regards to the need-based provisions would, if enacted, hurt poor people?

Mr. WALLACE. Well, I don't think they will hurt poor people in any significant way at all. The reforms in fact were rather finally tailored so as to catch those people who are dishonest and, i.e., abusing the system and not to effect those people who are honestly trying to obtain relief. That is the whole purpose of the presumption that was mentioned before and the standard of abuse in 707(b). I don't see how you can argue that a debtor who hasn't abused the system is going to be significantly limited in terms of their relief. There are some other provisions in the Bankruptcy Reform Act that apply regardless of whether or not you are above or below the means system. But each one of those is tailored to stop a specific form of abuse. So I think that the simple answer is that if you are poor and you are honest and you are trying to get relief honestly and making full disclosure of your assets liabilities, incomes and expenses, you will get relief just as you do today. And that is the whole point of the bill, is to preserve that relief, and that is why this bill will not have any significant effect upon those who deserve bankruptcy relief in this economy in its flat period.

Mr. CHABOT. Thank you.

Ms. Miller, will you agree that the current pending legislation is, for lack of a better term, less harsh on debtors than the bills that we considered back in the 105th and 106th Congresses?

Ms. MILLER. It would be hard for me to conclude that because I still think it is harsh on debtors. It is the means test that is harsh.

Mr. CHABOT. Well, I said less harsh. So I mean——

Ms. MILLER. It is hard for me to calculate whether or not it is less or more. I still—I think that the League's general position is that it does contain harsh provisions and that is going to have a negative impact on relief being available for debtors, both those that are businesses as well as those that are individuals. And if this bill were to pass, you are likely to see an immediate spike in filings as a result of people trying to fall under the current code, which is much less harsh than the proposed legislation has been.

Mr. CHABOT. Would any of the other panel members like to comment on whether this legislation is less harsh than the previous bills that we considered?

Mr. WALLACE. Well, a number of significant changes have been made since the bill was introduced in the 105th Congress. The means test has been substantially amended to protect—for example, I will just give you a specific example. If you have a special expense because of home heating oil costs that is specifically taken account of in the means test although the IRS guidelines did not specifically deal with that. These kinds of changes have been made over time step by step in compromise after compromise so as to moderate the effect of the means test, and I think that it is very hard to argue today that the means test is in any way harsh. I didn't think it was harsh when it was originally introduced and certainly isn't now.

Mr. CHABOT. Mr. Wallace, let me ask you another question. Ms. Miller had commented on a dog, for example, getting an application for a credit card. How would you respond to those who blame the credit card industry for the increase in consumer bankruptcy filings?

Mr. WALLACE. Well, I think that what is happening here in terms of consumer bankruptcy filings is at least two or three things are all interacting. First of all, there is the shift in the economy. Second of all, the bankruptcy profession, each time Congress gets close to passing this, encourages their clients to file and we get another bump. But in some very sophisticated research that was done by professors at Wharton and University of Chicago, research was done as to whether or not debtor willingness to use the bankruptcy system so as to discharge debt when they had the ability to pay was increasing, and they found that was increasing. We have also done studies which were introduced and presented to Congress in the 105th and 106th Congress which showed this was happening.

So I think we have a number of things that are happening here. Insofar as credit card solicitation, in this country of course we encourage companies to market their products. Sometimes people resist that marketing. I think that Ms. Beckwith's response is probably the best one. In a free economy where you are trying to allow companies on the one hand to market their products and on the other hand you want people to be able to protect themselves, education is the best way to deal with that. We all resent sometimes what those mailings are, but nonetheless the short answer is that can be handled best by education.

Mr. CHABOT. Thank you.

Mr. CANNON. Thank you.

Mr. Nadler, would you like 5 minutes?

Mr. NADLER. Thank you. Mr. Wallace, in your testimony you stated that the bill's critics are those with a vested interest in the system staying exactly as it is, close quote. Your client you describe as, quote, a broad coalition of consumer creditors, close quote. Could you please provide the Committee a list of your members so that the Committee can better assess whether they have any—whether your clients have any particularized interest in tilting the Code in their favor against the interests of our creditors or the broader public policy goals of the Code? So I am just requesting you supply us with a list of those clients. Could you do that?

Mr. WALLACE. I don't know. I mean I will talk with the people at the Coalition, sir.

Mr. NADLER. You don't know if you can supply a list of the people on whose behalf you are testifying so that we can assess the——

Mr. WALLACE. I assume I can, sir.

Mr. NADLER. Can you name some of them now?

Mr. WALLACE. No, I can't.

Mr. NADLER. So right now you are a stealth witness? Thank you. Ms. Beckwith. But we look forward to that list.

Ms. Beckwith, when I was talking to you last, you astonished me by saying that you couldn't state whether you really would insist that a provision remain in the bill that exempted the credit union from the requirement that you can't reaffirm agreement in such a way as to require the debtor to pay more than their total disposable income. I now request that you submit to the Committee as soon as possible a definitive answer. Do you insist on that unconscionable provision or do you not insist on that unconscionable provision? That will tell us frankly about the—how much we should pay attention to your testimony.

[The material referred to follows:]

The Honorable Chris Cannon
Chairman
House Judiciary Subcommittee on Commercial
and Administrative Law
B-353 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Cannon:

Thank you for your gracious remarks and respectful treatment at yesterday's hearing on bankruptcy abuse reform. It was indeed a privilege for me to volunteer my time on behalf of the Credit Union National Association (CUNA) to assert my Constitutional right to petition my government.

The purpose of this letter is to respond to the request of me by one of the Subcommittee members regarding CUNA's position on the reaffirmation provisions in H.R. 975. I was asked whether CUNA would agree to an amendment to require credit unions to comply with the more cumbersome reaffirmation requirements in the bill. **Let me make it perfectly clear that CUNA would strongly oppose any amendment or bill designed to require more difficult reaffirmation procedures for credit unions and their members who wish to voluntarily reaffirm their debts.**

You may recall that this provision is already a product of compromise. The original House bill totally exempted credit unions from its reaffirmation provisions. These provisions were modified in conference in response to the Senate's insistence. Ultimately, Congress recognized that credit unions and their members have a special relationship with each other and that in a credit union, this relationships results in protecting the members' rights to voluntarily reaffirm their debts. This ensures that the member has continued access to reasonably priced products and services. Without the ability to voluntarily reaffirm with their credit union, many members would be forced to seek credit from high-priced credit grantors, which could charge as much as 25 percent or more for loans.

Reaffirmations save the credit union and all of its members from suffering losses, which would otherwise have to be picked up by each member. This keeps costs down for the credit union and its members. In addition, the credit union works with the member to help repair their credit history and to avoid future financial problems. This is consistent with the credit union philosophy of "People Helping People."

I would appreciate it if you would distribute this response to the rest of the Subcommittee and make it a part of the hearing record.

I would also like to submit for the hearing record the enclosed copies of the two surveys referred to in my written testimony, as well as a copy of my response in the same edition of the *Credit Union Journal* to the Jim Blaine article submitted at yesterday's hearing.

Thank you again for the opportunity to provide the Subcommittee with CUNA's views on the need to pass bankruptcy abuse reform legislation as soon as possible.

Sincerely,

Lucile P. Beckwith
President/CEO
Palmetto Trust Federal Credit Union

Encls.

Penn, Schoen & Berland
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Suite 700
Washington, DC 20036
Tel: (202) 842-0500
Fax: (202) 289-0916

Bankruptcy and Public Opinion
Summary of Findings

To: Interested Parties

From: Robert Green
Penn, Schoen & Berland Associates, Inc.

Date: November 13, 2002

According to a nationwide study conducted by Penn, Schoen & Berland Associates, voters in the United States strongly support bankruptcy reform and believe that most people do not use credit responsibly.

The key findings listed below have been taken from a national telephone poll conducted among 1000 registered US voters. The overall margin of error for this study is +/- 3.1% at the 95th confidence interval.

Key conclusions are as follows:

1) The overarching consensus among voters in 2002 is that people do <u>not</u> use credit responsibly. More that two-thirds of voters feel that is it "too easy" to declare personal bankruptcy. This finding holds true across all major demographic groups.

2) Most (82%) voters believe that bankruptcy is more socially acceptable now than it was a few years ago and most (79%) also believe that bankruptcy filings have risen in recent years. Few voters (5%) believe that the number of filings has actually dropped.

3) A large majority of voters (61%) favor a tightening of bankruptcy laws in the US. And among those who know someone who has declared bankruptcy, 69% favor such a tightening of laws.

4) Among those that favor a tightening of bankruptcy laws, the most common reason is that they feel they are bearing part of the burden for the current system. Fifty-three percent of voters feel this way. Another 41% believe that tightening bankruptcy laws will help people use credit more responsibly.

5) When it comes to actual solutions, voters favor adding an income test to the current set of bankruptcy laws. Although it is not, many think that this is already part of the system.

6) More than half (56%) of voters strongly favor an income test to ensure that bankruptcy filers, who can afford to do so, pay back part of their debt. Another 22% somewhat favor this measure. This makes the overall support level fully 78% for this proposal.

7) The current state of our economy should be a call to action...not inaction. Sixty percent of US voters believe that bankruptcy laws should be tightened even though the economy is not as good as it was years ago. Only 20% disagree with this statement.

When it comes to credit and bankruptcy, voters appear to want responsibility and accountability both on the part of consumers and the legal system surrounding bankruptcy. Overall, these survey results illustrate strong support for a tightening of bankruptcy legislation in the US. Whether male, female, Republican, or Democrat, voters believe that Americans are not using credit responsibility and that the system needs to be changed.

Voter / Consumer Research
516 C St NE
Washington DC 20002
p (202) 546-8990
f (202) 546-8991

Memorandum

To: Richard Gose / Credit Union National Association

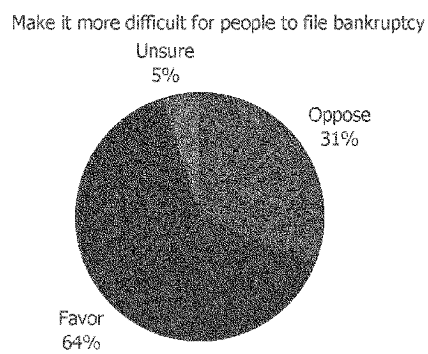
From: Jan van Lohuizen / Katie Reade

Date: Feb. 13, 2003

Re: Bankruptcy Reform

Background: We recently conducted a survey on financial institutions, services, and other issues dealing with the financial services industry on behalf of CUNA. We interviewed 1000 registered voters between January 21st and January 26th of 2003. There is a margin of error associated with the survey of !3.1%. One of the questions concerned bankruptcy reform. The results continue to show that **the public feels strongly that it should be made more difficult to declare bankruptcy**.

Detail: We asked people if they "Strongly favor, somewhat favor, somewhat oppose, or strongly oppose… making it more difficult for people to file for bankruptcy". Sixty-four percent of the American public are in favor making it more difficult to file for bankruptcy.



Support for bankruptcy reform is broad based. We found the same levels of support in all regions of the country and for both males and females. Credit union members support bankruptcy reform at the same levels as non-members.

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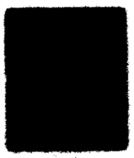


OPINION

In This Section

Only Thing Bankrupt Is Logic Behind 'Reform'

By Jim Blaine

The holiday season is a wonderful way to end the year! A time of faith, family, fellowship and–lest we forget–feasting! Food, food, and more food! Provocatively tempting aromas and tantalizing tastes, all–ah-h-h-h!–well worth the weight! And, the main focus of the feasting, the *sine qua non* is usually A FAMOUSLY FAT TURKEY; which, of course, brings to mind the oft-pedaled, but yet to be passed BANKRUPTCY ABUSE REFORM ACT (C'mon, quit acting so shocked; you knew darn well this was coming sooner or later! Get over it! Here it is!)

About the Bankruptcy Abuse Reform Act, Oscar Wilde said it best: "It is often with the best intentions that some of the worst work is done." Pretty perceptive of Wilde in that he–like most of the rest of us–never read, let alone studied, this 400-page magnum ugly opus. Yet even a cursory review of the act quickly reveals that –just like that holiday turkey–this particular "bird" has been fully "stuffed" by way too many cooks–all seeking to suit their own particular tastes.

All of us do feel betrayed when a member defaults on a loan. After all, the credit union is a cooperative and the member did "promise to pay." Plus, most of us can relate a tale or two of "woe and abuse" featuring "shifty" members, "opportunistic" lawyers and "bleeding heart" judges. The only problem with these yarns is that much like political campaign promises and stories of male, pre-teen sexual conquests, they usually don't hold up real well to serious scrutiny!

Just .19% (less than 2/10th of 1%!) of total credit union loans result in a bankruptcy loss. Not exactly a shock wave of loss and abuse, is it? Is it?

Credit Union Lending Statistics

Year	Total Loans	Allowance For Loan Losses (ALL)	Additions To Allowance*	Actual Charge-offs*
2001	$322B	.87%	.32%	.46%
2000	$301B	.89%	.33%	.42%

* As percentage of total loans

Real Live Facts

For example, take a look at the two charts with data from www.ncua.gov. Here are a few "facts" that are actually true!! First, credit union lending remains very strong–up 7% to $322 billion at Dec. 31, 2001. Loan delinquency is well controlled at .85% (less than 1%!) and is down by 15% over 1997. The allowance for loan loss (ALL) is actually lower at .87% than at the end of 2000!

Collectively we added .32% to the loan loss reserve in 2001, a bit less than in 2000. Since credit unions are required by federal statute and GAAP to accurately assess and accrue our potential loan losses through the ALL, the future apparently looks very bright to the CEOs who faithfully attest to credit union financial statements. (We are reporting "good numbers"–aren't we?)

Charge-offs, too, are well under control at .46% of total loans (less than ?%). In other words, 99.5% of credit union loans are repaid as promised. According to NCUA 41.1% of credit union charge-offs are related to bankruptcy. Or said another way, just .19% (less than 2/10th of 1%!) of total credit union loans result in a bankruptcy loss. Not exactly a shock wave of loss and abuse, is it? Is it?

Overall Credit Union Delinquency

2001	.85%	**Down 15% From 1997 to 2001!**
2000	.74%	
1999	.75%	
1998	.88%	
1997	1.01%	

But, hold on, there's more. In 1999, the Government Accounting Office (GAO) thoroughly analyzed the issue of personal bankruptcy. The GAO is the federal government's impartial watchdog. The GAO particularly looked at three financial industry studies of bankruptcy loss and abuse. Ernst and Young conducted two of the studies sponsored by VISA and Mastercard! Creighton University also sponsored a study, as did the Executive Office for U.S. Trustees (EOUST). Some interesting results.

Even Studies That Are Creditor Friendly...

These reports looked at bankruptcy filers who could pay something if bankruptcy had a "means test" (as the current bill promotes). The assumptions were very creditor friendly, assuming, for example, that filers' incomes and financial circumstances would not change during bankruptcy. Even so, the following were the results of the studies indicating "under best-case scenarios" who could pay. The "can pays" are those described as "abusers" in the current debate hype. (Those who would be forced into a Chapter 13 plan.)

So, based on industry-sponsored studies, the maximum "abusive level" of bankruptcy is between 3.6% and 15%. (Remember, these are industry-sponsored studies!!)

Estimated 'Can Pays' As Percentage Of Total Filers

Ernst & Young Study (1998),	15%
Ernst & Young Study, Executive Office of U.S. Trustees Study (January 1999)	10%
Creighton Univ. Study (1999)	3.6%

So, let's calculate what abuse means. First, remember we calculated above that total bankruptcy losses were .19% of credit union loans losses. (Total charge-offs .46% x 41.1% related to bankruptcy = .19%). Therefore, the range of loan losses related to "abusive bankruptcy" would be calculated as follows (based on the GAO studies):

Estimated level of abuse: 15% in the 1998 Ernst & Young study; 10% in the 1999 Ernst & Young and Executive Office of U.S. Trustees study, and 3.6% in Creighton University's 1999 study

Maximum Range of Losses from "Abuse":

* .19% x 15% = .0285% (less than 3/100ths of 1%!) highest estimate

* .19% x 10% = .019% (less than 2/100ths of 1%!) mid-range estimate

* .19% x 3.6% = .0068% (less than 1/100th of 1%!!!) lowest estimate

Perhaps a clearer translation of these statistics is if credit unions want "to overcome bankruptcy abuse" all they need to do is raise loan rates by one to three one-hundredths of 1%. Worst-case cost of "bankruptcy abuse" on credit union lending rates is three basis points! (Some of you spend more on board planning sessions!)

Credit unions have many issues far more important than "one to three basis points." One of those problems could be the following three paragraphs from a September 2002 letter from Ralph Nader to CUNA CEO Dan Mica:

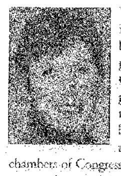
"It is extremely disappointing to see the Credit

Continued on next page

THE CREDIT UNION JOURNAL · FEBRUARY 24, 2003

Why Credit Unions Need To Continue To Support Bankruptcy Reform

By Lucile P. Beckwith



What's in a name? In politics, sometimes quite a bit. After the 106th Congress ended in late 2000, CUNA went to Congressman George Gekas, then champion of the bankruptcy reform bill that had passed both chambers of Congress only to die because of a veto, with a simple yet profound suggestion: Change the name of the bill.

Up until then, the legislation had been called simply "bankruptcy reform." But what was apparent to CUNA lobbyists, as well as league and credit union activists who carried first-hand stories of members who file for bankruptcy protection despite having the means to repay some (if not all) of their debts, was the reality that "abuse" was the real impetus behind our support of the bill.

Thus, the "Bankruptcy Abuse Prevention and Consumer Protection Act" was born. The legislation has represented a fair and reasonable attempt to rein in what a member of our credit union board called "using a bankruptcy as a financial planning tool."

Statistics Well-Known

By now, the statistical side of the story of bankruptcy is well known. Since 1983, there has been an increase in the number of bankruptcy filings in every year but two. In 1990, the beginning of a decade of real and sustained economic prosperity, just over 700,000 Americans filed for bankruptcy. In 2001, that number had doubled to 1.4 million, a new record that looks to be broken when final 2002 statistics are tallied.

The numbers alone don't tell the whole story, however. What seems to have also changed, and contributed to the soaring rate of bankruptcy filings, is a change in societal attitudes about bankruptcy. Time and time again, credit union professionals and volunteers hear from members who take a cavalier, almost indifferent attitude toward filing for bankruptcy. Some, like a Minnesota man who retired to Florida after declaring a $30,000 bankruptcy, write glowing accounts to his hometown newspaper about how much he is enjoying his retirement, courtesy of the members of his credit union.

> The legislation has represented a fair and reasonable attempt to rein in what a member of our credit union board called "using a bankruptcy as a financial planning tool."

Others, such as two members of my credit union, a couple with a six-figure income, who each qualified for $10,000 VISAs (at the same time they were applying for other credit cards), openly game the system. During one month they maximized all these credit cards with cash advances. They never made a payment on any of them, waited the required time, and then filed for a Chapter 7 bankruptcy. An appeal to the court for "loading up" was denied. Our small credit union lost $20,000. What did they do with the cash? Their daughter had a very large, beautiful and expensive wedding in Hawaii–a long way from South Carolina.

> I can support the bill that has been considered by Congress, and I can continue to support it as a way to discourage the abuse that has come to characterize the bankruptcy system.

Although measuring stigma is not an easy task, a study done by the Cato Institute detailed several revealing glimpses into bankruptcy filing patterns. The Cato study cited surveys that found that 45% of consumer bankruptcy filers learned about bankruptcy from friends or family. Ten percent of filers were identified by Cato as repeat filers and 27% said they would consider filing again. Our small credit union has had at least two repeat filers who did not reveal their previous bankruptcies because they were past the time limit.

The absence of any stigma is contributed to, if not caused by, the prevalence of attorneys who specialize in bankruptcy filings. In our area the media, especially television, newspapers, and household mailings, is saturated with advertisements from bankruptcy attorneys offering to "relieve the pressure of monthly payments."

To be sure, not every bankruptcy filing is abusive. There is no question that the need for protection from creditors is something that consumers should have access to, and something that credit unions favor. I could not endorse a bill that denies people necessary bankruptcy protection. We all know of situations where a member is the victim of unforeseen financial calamity, often associated with the loss of a job, a divorce, or illness. But I can support the bill that has been considered by Congress, and I can continue to support it as a way to discourage the abuse that has come to characterize the bankruptcy system.

Look at what the bill does:

* It establishes a "means test" that determines whether a filer should be granted Chapter 7 versus Chapter 13, based on income and ability to repay. In other words, if you have the wherewithal, you shouldn't be able to simply walk away from your obligations. The bill also requires debtors with incomes above the median to submit a repayment plan, while accounting for living expenses

* It restructures current law so that child support and alimony payments are at the top of the list of items protected from discharge. Currently, other payments take precedence over child support and alimony, including attorney's fees!

* It protects the rights of credit union members to voluntarily reaffirm their debts.

* It mandates financial education, which I believe to be a prudent and practical way to help people with credit problems to stay out of future trouble. Plus, it's a natural fit with the credit union priority on financial literacy.

Imperfections, But...

All of this adds up to a bill that would create a fairer and more realistic bankruptcy code. Credit union members, because they own their institutions, feel the effects of abusive bankruptcies directly. And while no one is arguing that the bankruptcy legislation will completely eliminate the abuse, no one should argue that the bill isn't necessary because it isn't perfect. If I could add one amendment to the bill it would penalize creditors who approve credit to over-extended borrowers. The best way to help an over-extended consumer is to say "no" to a credit request.

It is my hope that the bankruptcy abuse bill passes, that judges carefully follow the new law so that they take a more realistic view of people's capacity to repay their debts, and, perhaps most importantly, a renewed sense of individual accountability becomes apparent.

Maybe we ought to change the name of the bill again. My suggestion: the Personal Responsibility Act.

Lucile P. Beckwith is president/CEO of Palmetto Trust FCU in Columbia, S.C., and also a member of CUNA's Governmental Affairs Committee.

National Association of Federal Credit Unions
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(703) 522-4770; (800) 336-4644; Fax (703) 522-2824
www.nafcu.org

March 5, 2003

The Honorable Chris Cannon
Chairman
Subcommittee on Commercial and Administrative Law
House Judiciary Committee
B353 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Cannon:

The National Association of Federal Credit Unions (NAFCU), the only national trade association that exclusively represents the interests of the nation's federal credit unions, would like to express its unequivocal support for provisions in H.R. 975, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2003" that preserve the right of voluntary reaffirmations for credit union members.

As you are aware, this became an issue in your Subcommittee hearing yesterday when a question was asked of the Credit Union National Association witness by Representative Nadler. It is NAFCU's position that it is critical that any bankruptcy reform bill preserve this right of voluntarily reaffirmation for credit union members. Let me also state that NAFCU is not a member of the Coalition for Responsible Bankruptcy Laws and remains to this day an independent voice speaking for credit unions and their members in the bankruptcy reform process.

Credit unions traditionally have higher reaffirmation rates than many other lenders because their members recognize that since the credit union is a member-owned cooperative, their fellow credit union members will be forced to bear the costs of any debt discharged in bankruptcy. The higher credit union reaffirmation rates reflect other characteristics central to the credit union philosophy as well, such as the belief that credit union members who legitimately invoke the opportunity for a "fresh start" available to them under the bankruptcy laws should be allowed to retain their relationship with their credit union through the reaffirmation process, rather than forced to sever that important relationship and doubtlessly pay higher prices for financial services elsewhere.

We are pleased that H.R. 975 contains these provisions that preserve the right of voluntary reaffirmation for credit union members and urge you to oppose any efforts to remove them. If you or your staff should have any questions or would like further information, please do not hesitate to contact NAFCU's Senior Legislative Representative, Murray Chanow, or me at (703) 522-4770. Thank you for giving me this opportunity to share NAFCU's views on this important matter.

Sincerely,

Fred R. Becker, Jr.
President and CEO

cc: The Honorable James Sensenbrenner

Mr. NADLER. And, Mr. Wallace, coming back to you, according to a credit card industry funded study which you just quoted a moment ago that what you suggest by this bill, some of them done by Dr. Staten, the rates of discharge debt that might otherwise be paid are in the range of 25 percent, according to Dr. Staten's testimony before this Committee in 1999. You dismissed the only non-industry study commissioned by what you call the, quote, pro-consumer American Bankruptcy Institute, close quote, which found using the same data that it was only approximately 3 percent. Do you really believe first of all that the ABI, which is composed of bankruptcy professionals from all parts of the profession, including creditor counsel, is really pro-creditor because that would come as a shock to the creditor attorneys who are members and serve on the board? But secondly, are you aware that Dr. Staten, who testified before this Committee that it was 25 percent back in 1999 and whom you have quoted today, speaking on a panel on consumer debt sponsored by the FDIC last week, commented that the bill would have no effect on the number of bankruptcies and that it would at most move 5 percent of debtors from chapter 7 to chapter 13?

Mr. WALLACE. Actually, I exchanged e-mails with Mike Staten yesterday on this topic, and he pointed out that at the time that he said that he didn't realize the bill was being introduced. He was unfamiliar with its provisions.

Mr. NADLER. He has been working on this bill for the last 5 years. It is the same bill as last year.

Mr. WALLACE. He also pointed out that there are a number of provisions in the bill, a wide range of provisions in the bill and his opinion was addressed only to specific narrow provisions of the means test, and that if he was asked the question with regard to the whole bill, he would say that it would have a substantial impact. I am just giving you the answer that he gave me, sir.

Mr. NADLER. Well, so you are saying he was only talking about the means test. The means test would only move 5 percent. Do you agree with that?

Mr. WALLACE. I don't know what his research is, sir.

Mr. NADLER. I see. So, well, I can't believe that Dr. Staten was saying he was unfamiliar with this bill, which is the same as last year, which he has been working on for the last at least 5 years.

But let me come back to the question I asked a moment ago. Do you really think that the American Bankruptcy Institute is one-sided, pro-debtor; is that your testimony?

Mr. WALLACE. Well, I am a member of ABI and I think that in general that the ABI's positions with regard to that study were decidedly pro-consumer; that is, they were pro-debtor.

Mr. NADLER. Could Ms. Miller comment on that? Do you think the ABI has been fairly dispassionate on this question down the line or not?

Ms. MILLER. I really couldn't comment right now. I mean——

Mr. WALLACE. I mean one thing is that the study

design—you mentioned two different studies. If you want to get into the details of the study design, the study design changed. ABI changed the study design and they got a different result even though they were using the same data. So I mean you have to be very careful about these things.

Ms. MILLER. Congressman, I will note, however, that this week the ABI did submit a proposal to Congress setting forth a number of proposed amendments to this bill and criticizing substantially a number of the provisions that would be before Congress.

Mr. NADLER. Thank you.

Mr. CANNON. Thank you, Mr. Nadler. Did we accomplish your objective in the 30-second extension?

Mr. DELAHUNT. No, Mr. Chairman, and since we are here in a nice relaxed environment——

Mr. CANNON. The gentleman is recognized for 5 minutes.

Mr. DELAHUNT. If you will indulge me. Mr. Wallace, I want to be clear. I mean, you are not refusing to disclose who the members are?

Mr. WALLACE. Oh, no, sir. I just don't know. I represent—I mean, American Financial Services Association is here today and they just told me that I can disclose their name.

Mr. DELAHUNT. Sure. Oh, come on. Who else makes up the Coalition for Responsible Bankruptcy Laws? I mean, you are here.

Mr. CONYERS. Would the gentleman yield?

Mr. DELAHUNT. I will yield and I will ask for some time from you.

Mr. CONYERS. Is this another secrecy deal here? I mean, I guess we have to assume—you are not under oath, sir, but you are testifying before a Congressional Committee and I am—I think you are aware of what that implies.

Mr. WALLACE. I am trying to.

Mr. CONYERS. I guess you are aware.

Mr. WALLACE. I don't know who.

Mr. DELAHUNT. Reclaiming my time, you know, you have been here on three separate occasions, Mr. Wallace. Presumably, your fees are being paid by the Coalition for Responsible Bankruptcy Laws. Who are the constituent members of the Coalition for Responsible Bankruptcy Laws?

Mr. WALLACE. I am a lawyer. I come here and I testify. I haven't talked to anybody. I don't know who is in the coalition at this particular moment.

Mr. DELAHUNT. Well, you know, please. I mean, you know, it says right here on behalf of the Coalition. You are here testifying on behalf of the Coalition for Responsible Bankruptcy Laws. Is that a misstatement?

Mr. WALLACE. No. The Coalition members are——

Mr. DELAHUNT. It is not. So then you don't know who your client is. Is that what you are telling me?

Mr. WALLACE. My client is the Coalition. You asked who the constituent members of the Coalition are. It is a large group of creditors.

Mr. DELAHUNT. Give me five of them.

Mr. WALLACE. Well, American Financial Services Association is here. The Credit Union National association is here. The National Retail Federation is here. The Bond Marketing Association I understand is a member of it. The American—the Landlords Association is here.

Mr. DELAHUNT. That is fine. That is all we were looking for. You know, again, let me get back to——

Mr. WALLACE. I mean, I didn't mean to be nonresponsive.

Mr. DELAHUNT. Well, you were nonresponsive.

Mr. WALLACE. You asked me a question and I don't know what the answer was.

Mr. DELAHUNT. You know, you are not here, I presumably out of the goodness—this isn't an act of altruism on your part. Usually we know who is paying our fees, and I am sure you are being well paid and that is good. But, you know, to the American Bankruptcy Institute that study that you seem to question, it is my understanding that the results of that study were supported by the Executive Office of the United States Trustees, which conducted a similar effort that reached similar results, estimating that the passage of the conference report on H.R. 33 probably would have netted creditors no more than 3 percent of the $400 per household they claim to be losing.

Now, is that a fair and accurate statement, Mr. Friedman?

Mr. FRIEDMAN. Congressman, first of all, this is the anniversary of my 1 year at the Executive Office, and I must confess to you that I haven't reviewed that study.

Mr. DELAHUNT. Have you heard rumors about it while you have been in the, you know, while you were in the building?

Mr. FRIEDMAN. I was not reclusive prior to my life here as Director.

Mr. DELAHUNT. Okay. Well, I won't press the issue with you. But we keep hearing these $400 and we are going to save interest rates and the cost to the taxpayer and you are familiar, you know, with the study that over a 10-year period Federal funds rates went down 13 percent to 3 percent and the cost of interest on credit cards went from 17.20 to 17.6.

So let's just be honest and candid. This is a bill by and for the credit card industry. That is the bottom line. And with that, I will yield back.

Mr. CANNON. Thank heavens. It is amazing how quickly the 5 minutes go when it is your own time and how long it takes some other times.

Does the gentleman from Michigan wish 5 minutes?

Mr. CONYERS. Thank you, Mr. Chairman. I want to thank the gentleman from Massachusetts, Mr. Delahunt, for getting us beyond this attempted cover-up. We have got the Vice President of the United States who refuses to tell us who he was meeting with. We are in court about that. We have foreign affairs expert, Mr.——

Mr. CANNON. If the gentleman would yield, I think we are actually out of court on that with no obligation to disclose.

Mr. CONYERS. Oh, you made it out? Okay. Well, that is great, and I am glad you are relieved about that. Now, we also have Henry Kissinger, who declined a presidential appointment because he refused to reveal his client list and so he quit rather than do that. And now we have you, a distinguished lawyer who has been before the Committee on several previous occasions on the same subject that had a great deal of difficulty recalling a few of the names of the member organizations of the Coalition for Responsible Bankruptcy Laws, which of course leads a person like myself to wonder who else is in this organization that causes so much amnesia, which I will deal with at another time.

But I want to turn to Ms. Beckwith and this is in all friendliness. Ms. Beckwith, you have indicated that you have people in your credit union, a couple, that did three, four, five, six, seven credit cards all at once and ripped off. How do you handle that now?

Ms. BECKWITH. Congressman, at the time these people——

Mr. CONYERS. Well, you have got to answer real briefly and succinctly, please.

Ms. BECKWITH. Yes, sir. We handle it by checking everyone's creditworthiness just like we did with that couple. They were out to beat the system and they did.

Mr. CONYERS. Well, in other words, has this happened since that couple that you reported? Has there been another occasion?

Ms. BECKWITH. We have had other occasions where people have done something similar.

Mr. CONYERS. In other words, you are telling the Committee that without this law, this bill that we are trying to turn into a law, your credit union—and I happen to be a strong supporter of all unions, not to mention credit unions.

Ms. BECKWITH. Thank you, sir.

Mr. CONYERS. You are telling us that you have no remedy unless you get this law, or are you telling me that?

Ms. BECKWITH. Yes, sir, I am telling you that. We need this law desperately. The expenses to my credit union are growing year by year and it is affecting our bottom line. It is affecting——

Mr. CONYERS. Because people are doing what you—like the couple you related in your testimony?

Ms. BECKWITH. Yes, sir.

Mr. CONYERS. And if you don't get this law you are going to still get ripped off some more?

Ms. BECKWITH. Yes, sir, we are.

Mr. CONYERS. Well, has it occurred to anybody in the union to track, keep track of the people you give credit to after you give them a credit card?

Ms. BECKWITH. Yes, sir, we do.

Mr. CONYERS. Well, if you do, that would show up, wouldn't it, if they get other credit cards from somewhere else?

Ms. BECKWITH. Yes, sir. We check our members as they come up for renewals every 2 years.

Mr. CONYERS. Every 2 years.

Ms. BECKWITH. Yes, sir. We are a small credit union. It is only 11 of us.

Mr. CONYERS. Eleven people working there?

Ms. BECKWITH. Yes, sir.

Mr. CONYERS. How many members?

Ms. BECKWITH. Thirty-seven hundred.

Mr. CONYERS. Well, it is funny to me that I haven't been hearing this from most other unions. Of course you are testifying on behalf of a much larger organization. But it seems to me that there must be some way we can protect this other than passing a bill to help out the credit unions that may have somebody that wants to rip them off. I mean, can't you check? What about banks? What about all other financial institutions that give out credit cards? Are they all subject to this same sort of policy as well?

Ms. BECKWITH. Yes, sir.

Mr. CONYERS. They are?

Ms. BECKWITH. Yes, sir.

Mr. CONYERS. Okay. Thank you very much.

Mr. CANNON. Thank you, Mr. Conyers. We have had a unanimous request, consent request that we allow 2 days for Members of the Committee to submit written questions to the members of the panel and that the members of the panel be given an additional 3 days to answer those questions. That would be questions would be due by Thursday at 5 and answers would be due next Wednesday at 5. Without objection, so ordered.

Thank you. You know, I personally believe that the law is a great teacher and, in looking at what is going on, I think that we have a fundamental trend and, Ms. Miller, if we could get back to what we were talking about before, I would just like to have you help me make that distinction. Do we have a fundamental trend in society where people have learned that bankruptcy is an easy out, that you can con the system, you can actually make money by doing this credit card busting process and other processes and so we are increasing a very bad trend with bad law today, or do you believe that this increase in bankruptcy is temporary, that there is some turnaround in society's mores and that when we get to a more substantial economy the bankruptcy filings will tail off or decline significantly?

Ms. MILLER. It seems as though today focus has been on not only abuse but the egregious cases, and everybody can point to egregious cases that exist out there. But where are the studies on abuse and, as Congressman Delahunt pointed out, there are——

Mr. CANNON. Pardon me.

Ms. MILLER [continuing]. There are other remedies.

Mr. CANNON. But my question is different. Do you—I am not so much talking about abuse because that is part of the question. But are we seeing a tendency? We need to correct the law here and, Mr. Wallace, I would like to turn this to you in just a moment. But we need to correct the law because people have a fundamentally wrong idea, as Ms. Beckwith has been talking about, the educational process of credit and what the law means for people and their understanding of what to do. We have talked about the very painful results of taking out bankruptcy, which people apparently aren't paying attention to. Is this a fundamental problem in your mind?

The reason I am asking this is because you are talking about—you are taking today a very different position from what you have taken in the past on this issue. I am just trying to focus on whether your rationale for that is that the transformed society is what is causing increased bankruptcy as opposed to the—what you testified earlier about this.

Ms. MILLER. I don't believe my testimony before this Subcommittee previously is different than what it has been today. I think the economy is definitely different. Do I think that the increase is going to continue? I guess it depends on the strength of the economy. But, you know, all—we have been focusing so much on the consumer issues today and abuse regarding individual debtors. There hasn't been much attention paid to the business provisions. There hasn't been much analysis done to the business provisions. Small businesses, family-owned businesses are facing financial crises. The bill makes it much harder for these businesses to reorganize. It takes away discretion from the court to be able to deal with them and ultimately doesn't provide for a maximization of their assets for the benefit of creditors. It is—the increases—we all know there is some abuse out there. But the presumption that the increase is all due to abuse or that it is easy to file, I don't think people easily make the decision to file generally.

Ms. MILLER. I think they try every which way and go into denial not to file as long as they can, and it is only when they reach the end of the rope or they have no other alternative but to file——

Mr. CANNON. If I might suggest, knowing people who have filed bankruptcy and—I am not sure that is the case. I am not sure that people—I don't think that this—two things you have here. One is abuse. The other one is filing stupidly and then finding out you have massive problems that your friends, who told you how cool it was to get out of the debt, didn't tell you about after the fact.

There are—the third category, of course, is what you are talking about, generally speaking, which is people who have problems, either health problems or they lose their job. There are a whole bunch of reasons why—those are the two biggest—why people need to take out bankruptcy. But the marginal people that are going to I think destroy their lives is the question I am asking you—and then maybe, Ms. Beckwith, if you want to respond to this as well—is that not unfair to these people and shouldn't the law be a harder guide, a clearer guide?

Ms. MILLER. You are changing the law to be—or you are taking the pendulum and moving it from one extreme to the other to address the potential abuse by a few and making it harder for those that have honest problems, have lost their jobs, on the eve of a foreclosure are trying to file to save their home and to figure out how to reorganize they lives. It seems as though, rather than taking a hammer and moving the pendulum from one extreme to the other, that there is a halfway moderate approach that could be taken that is not making it more difficult for even those that are honest debtors out there who have filed legitimately and need financial relief.

Mr. CANNON. I have very little time, and I don't want to abuse the system. If you would like to just answer, Ms. Beckwith?

Ms. BECKWITH. Mr. Chairman, there are some people out there who use bankruptcy as a financial planning tool; and there are no ifs, ands and buts about that. It happens. When we look at credit reports after a bankruptcy is filed, we can see this. Many of the bankruptcies we receive, the debtor is not even delinquent when we received the bankruptcy.

Mr. CANNON. Thank you. I would like to thank the panel. This has been——

Mr. CONYERS. Mr. Chairman, aren't others being heard besides yourself?

Mr. CANNON. That was the—that was my second round. So we finished the second round, and I don't think we——

Mr. CONYERS. Oh, you didn't begin the second round?

Mr. CANNON. No, I deferred.

Mr. CONYERS. I see. Thank you very much, sir.

Mr. CANNON. Thank you.

I want to thank the panel. It has been long, a little bit contentious, but, hey, the system is robust. We appreciate your being here and your sharing your testimony with us, and if you could answer questions that are submitted to you quickly, we would appreciate that very much. Thank you.

We are adjourned.

[Whereupon, at 4:01 p.m., the Subcommittee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

March 6, 2003

Lawrence A. Friedman, Director
Executive Office for United States Trustees
20 Massachusetts Avenue, NW
Suite 8000
Washington, DC 20530

Dear Mr. Friedman:

Thank you for appearing before the Subcommittee on Commercial and Administrative Law at the hearing on H.R. 975, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2003," and the need for bankruptcy reform on March 4, 2003. Your testimony, and the efforts you made to present it, are deeply appreciated and will help guide us in whatever action we take on the issue.

Pursuant to the unanimous consent request agreed upon at the hearing, Subcommittee Members were given the opportunity to submit written questions to the witnesses. Questions submitted by the Minority for your written response are annexed.

Your response to these questions will help inform subsequent legislative action on this important topic. Please submit your written response by 5:00 p.m. on Wednesday, March 12, 2003, to: Susan Jensen, Subcommittee on Commercial and Administrative Law, B353 Rayburn House Office Building, Washington, DC 20515. Your responses may also be submitted by e-mail to susan.jensen@mail.house.gov. If you have any questions, feel free to contact Ms. Jensen at (202) 225-2825. Thank you for your continued assistance.

Sincerely,

CHRIS CANNON
Chairman
Subcommittee on Commercial and Administrative Law

CC: sj

ONE HUNDRED EIGHTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON THE JUDICIARY

2138 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515–6216

March 6, 2003

http://www.house.gov/judiciary

Hon. Chris Cannon
Chairman
Subcommittee on Commercial and
Administrative Law
B-353 Cannon House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Attached, please find additional questions submitted pursuant to the unanimous consent request adopted at our hearing on bankruptcy legislation held on Tuesday, March 4, 2003. We believe that these questions are directly relevant to the matter under consideration and reflect members's concerns.

Should you, or any of the witnesses, have any questions concerning this matter, please do not hesitate to contact us.

Thank you for your consideration in this matter and for your willingness to accommodate our concerns. Please also extend once again our gratitude to the witnesses for their cooperation.

Sincerely,

John Conyers, Jr.
John Conyers, Jr.
Ranking Member
Committee on the Judiciary

Melvin L. Watt
Melvin L. Watt
Ranking Member
Subcommittee on Commercial and
Administrative Law

Jerrold Nadler
Jerrold Nadler
Ranking Member
Subcommittee on the Constitution

QUESTIONS FOR LARRY FRIEDMAN

- You have described the results of your National Civil Enforcement Initiative. It appears that the Program has made great strides in tracking down debtor fraud, and you cite a number of examples and some interesting statistics. Your presentation made no mention of any enforcement actions taken against creditors in cases involving fraud, violations of bankruptcy law or rules, misleading or erroneous filings, abusive or coercive conduct toward debtors, or misrepresentations to a party or in a proceeding? For example, to what extent has the Program been able to detect inaccurate or unlawful practices by creditors and their counsel, filing inaccurate notices of claim, or misleading debtors about the advantages of reaffirming unsecured dischargeable debt? Do you believe that such creditor abuse exist? If so, is it part of the Initiative and could you provide the Subcommittee with information and statistics on actions taken by the Program to deal with this problem?

- You note, on page 2 of your testimony, that "There is a consensus among bankruptcy professionals, including judges and practicing lawyers that documents filed by debtors .. Too often are inaccurate and ignore the requirements of the Bankruptcy Code and Rules." To what extent do debtors, especially those proceeding pro se, make errors or fact or law that work to their disadvantage. With the greater complexity of the changes proposed by the pending legislation, do you believe that this problem will grow worse?

- As you note in your testimony, any inaccurate financial disclosure, concealment of assets, and other fraud, can result in dismissal, denial of discharge, and criminal prosecution. In FY 2002, you state that more than 800 debtors, out of the 1.5 million, were denied a discharge on the grounds of serious misconduct. You also cite cases in which debtors have been found guilty of bankruptcy fraud. Do you believe that your program has been successful at ferreting out fraud? How much fraud or inaccurate reporting do you think still goes undetected? Do you think that through the use of criminal and civil penalties, denial of discharge under sec. 727, dismissal under 707, disgorgement actions, and other remedies you have described in your testimony, you have been able to catch and deal with everyone you caught? Could you give us a list of cases in which the Program lacked appropriate recourse under current law with respect to people on whom you have evidence of fraud, misrepresentation or other misdeed described in your testimony?

- How many cases identified by the US Trustee as constituting substantial abuse of ch. 7 could not be dismissed or converted under sec.707(b) as it now exists? Could you give some examples?

- Are there any provisions of this bill with which you disagree?

- Sec. 102(h) of the bill provides that if a debtor cannot provide for the payment in full of an allowed unsecured claim, then the debtor must devote all of her disposable income in the first three years of the plan to make payments to unsecured creditors. Under current law, a debtor must show that she will pay all her disposable income in the first three years of the plan to pay any kind of debts. Do you believe that a debtor, including one with under median income, should be required to pay only general unsecured debts, and not be allowed to make up arrearage on a home or a car in the first three years of a plan? In order to confirm a ch. 13 plan a debtor must provide for payment in full of all priority unsecured debts. Do you believe that non-priority unsecured debts should be given this special new advantage to the detriment of the other creditors or the debtor's ability to keep a home or a car?

– Title XI of the bill concerns health care insolvencies. As a former ch. 7 trustee, do you have any concerns about how a trustee would perform all the duties required under this title in an administratively insolvent case?

– In your testimony, you assert that you pursued more than "50,000 civil enforcement and related actions ... That yielded approximately $160 million in debts not discharged and potentially available for distribution to creditors." Do you know how much of that $160 million was actually, not potentially, collectable or in fact collected? As you know, just because a debt is discharged doesn't mean the debtor would have ever been in a position to repay it.

– Do you believe that the Program receives sufficient funds to maintain the National Civil Enforcement Initiative at a level you would find acceptable? If not, how much should Congress provide to ensure full implementation?

– Could you provide a section-by-section analysis of all the new duties that the US Trustees and the private trustees will have should this bill pass, and itemized the cost, and number of additional FTEs required for each new function, such as audits, storage of additional paperwork, additional notices? For example, sec. 102(c) of the bill requires the US Trustee to:

  - Review all materials filed by the debtor not later than 10 days after the 341 meeting,

  - within 30 days file a motion to dismiss or file a statement setting forth the reasons why such a motion would be inappropriate,

- Sec. 603 requires the establishment of audit procedures for debtors. It requires that these audits be performed by Certified Public Accountants or Licensed Public Accountants, to perform the audits according to Generally Accepted Accounting Principles. You will be required to audit one in every 250 petitions. At a rate of 1.5 million and rising, that would be at least 6,000 GAAP audits performed by CPAs. Additionally, you are required to perform audits whenever there is an indication that there is some variance from the norm. How many audits would you likely perform annually, how much would each of these audits cost, and what would be the overall cost of the mandate?

- You would also be required to screen and evaluate the accountants and the providers of financial management training and credit counseling. Do you know how much these evaluations and oversight will cost?

– Could you tell us what new costs new duties contained in this bill would impose on the private trustees? Do you anticipate any problems as a result of these costs?

– It has been estimated that more than 95% of all ch. 7 cases are zero asset cases. Has anyone in your office performed a cost/benefit analysis to determine whether, given the costs of these new mandates, there will be a sufficient return for the estate and the creditors. I assume you agree that it is irrational to have a bankruptcy system that spends more to collect a debt that then total value of the debt, or the amount of debt which is both due and collectable, whether or not a discharge is granted.

– There appear to be a great many duties and costs imposed on the US Trustee, Bankruptcy Administrator, the private trustees, the courts, the US Attorneys to collect private debts. To what extent do you believe that the government should be expending public resources to hunt for assets or income in order to satisfy private debts. Do you think that there ought to be some duty on the part of the creditor to expend some resources to pursue its own debt, or do you believe that the US Trustee program should become a collection agency for private parties such as credit card banks? How do you respond to Mr. Wallace's assertion that determining the availability of assets or income of a debtor or pursuing such issues in a 341 meeting or a 2004 examination are the job of the federal government and not the holders of claims. Are you concerned that this position would turn the US Trustee Program into a governmental collection agency for private creditors? Do you believe this would be appropriate?

– In terms of the integrity of the system, sec. 102 of the bill imposes penalties, including disgorgement of fees and, in some cases, civil penalties and payment of fees to opposing parities, for debtor attorneys under certain circumstances. The have proved rather controversial, especially the requirement that debtor attorneys certify the accuracy of the information in the debtor's schedules. Do you believe these attorney liability provisions are appropriate? Do you have any concerns that they will prove inordinately burdensome, raise costs for debtors, or result in more pro se debtors?

– Do you believe that the same attorney liability rules should apply to creditor counsel? The bill only provides for the payment of opposing party's costs, even in cases where Rule 9011 has been violated. Also, an entire class of creditors and their attorneys cannot be penalized under this provision even if they are found to have violated Rule 9011, which prohibits, among other things, presenting any document to the court that is "presented for any improper purpose, such as to harass or to cause unnecessary or needless increase in the cost of litigation" as well as the requirements that the legal positions and factual assertions are backed by a reasonable reading of the law and proper evidentiary support. Do you believe that any party in a case should be exempted from any penalty for having done these things?

– After all the scandals involving conflicts of interest on the part of financial advisors, investment bankers, accountants, and other entities, how do you justify sec. 414, which repeals the requirement that investment bankers must be "disinterested persons" in order to work as professionals in the case? How do you justify sec. 324 which overturns the *Merry-go-round* case by limiting the ability of an aggrieved party to seek redress against accountants who have engaged in some improper conduct in the case?

-- During the period 1994 to the present:

- How much did household debt increase?
- How much did consumer credit outstanding increase?
- How much did the annual number of credit card solicitations increase?

U. S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

March 11, 2003

The Honorable Chris Cannon
Chairman
Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Enclosed please find responses to questions relating to the appearance before the Subcommittee on Commercial and Administrative Law of Mr. Friedman of the Executive Office of U.S. Trustees on March 4, 2003. The hearing was entitled, "Bankruptcy Abuse and Prevention and Consumer Protection Act of 2003."

We thank you for the opportunity to respond. If we may be of additional assistance, we trust that you will not hesitate to call upon us.

Sincerely,

Jamie E. Brown

Jamie E. Brown
Acting Assistant Attorney General

Enclosure

cc: The Honorable Melvin L. Watt
Ranking Minority Member

3-10-03 7 p.m.

RESPONSE TO WRITTEN QUESTIONS FROM HOUSE JUDICIARY COMMITTEE'S SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW RE: HEARING ON MARCH 4, 2003

QUESTION 1:

You have described the results of your National Civil Enforcement Initiative. It appears that the Program has made great strides in tracking down debtor fraud, and you cite a number of examples and some interesting statistics. Your presentation made no mention of any enforcement actions taken against creditors in cases involving fraud, violations of bankruptcy law or rules, misleading or erroneous filings, abusive or coercive conduct toward debtors, or misrepresentations to a party or in a proceeding? For example, to what extent has the Program been able to detect inaccurate or unlawful practices by creditors and their counsel, filing inaccurate notices of claims, or misleading debtors about the advantages of reaffirming unsecured dischargeable debt? Do you believe that such creditor abuse exists? If so, is it part of the Initiative and could you provide the Subcommittee with information and statistics on actions taken by the Program to deal with this problem?

ANSWER 1:

Providing greater consumer protection for debtors is one of the primary purposes of the National Civil Enforcement Initiative. We presently are focusing on some of the most egregious fraud in the bankruptcy system, which is fraud committed by those who prey upon consumers in dire financial distress. In the past, with regard to reaffirmation abuse by creditors, the United States Trustee Program provided substantial assistance to the United States Attorneys, the Federal Trade Commission, and the State Attorneys General in various actions, both civil and criminal, to redress such abuse. Although we do not have recent examples of violations of the reaffirmation provisions of 11 U.S.C. § 524(c)-(d) and Fed. R. Bankr. P.4008, we would address such violations as they arise.

QUESTION 2:

You note, on page 2 of your testimony, that "There is a consensus among bankruptcy professionals, including judges and practicing lawyers that documents filed by debtors. . .too often are inaccurate and ignore the requirements of the Bankruptcy Code and Rules." To what extent do debtors, especially those proceeding prose, make errors of fact or law that work to their disadvantage. With the greater complexity of the changes proposed by the pending legislation, do you believe that this problem will grow worse?

ANSWER 2:

Inaccurate financial disclosure by debtors represents a significant challenge to the integrity of the bankruptcy system. Anecdotal evidence strongly suggests that such errors largely operate to the advantage of debtors. Although debtors who are poorly represented by counsel or who file pro se based on inaccurate advice from third parties, such as some internet petition preparers, can find themselves disadvantaged, experience suggests that courts are not inclined to sustain actions against innocent debtors.

We do not believe that the fraud and abuse provisions will exacerbate the problem of inaccurate financial disclosure. If H.R. 975 is enacted, we will work closely with the federal judiciary to develop appropriate Rules and Official Forms to capture the information required under the new legislation. We recognize that it is critical for the Official Forms to be as understandable as possible.

QUESTION 3:

As you note in your testimony, any inaccurate financial disclosure, concealment of assets, and other fraud, can result in dismissal, denial of discharge, and criminal prosecution. In FY 2002, you state that more than 800 debtors, out of the 1.5 million, were denied a discharge on the grounds of serious misconduct. You also cite cases in which debtors have been found guilty of bankruptcy fraud. Do you believe that your program has been successful at ferreting out fraud? How much fraud or inaccurate reporting do you think still goes undetected? Do you think that through the use of criminal and civil penalties, denial of discharge under Sec. 727, dismissal under Sec. 707, disgorgement actions, and other remedies you have described in your testimony, you have been able to catch and deal with everyone you caught? Could you give us a list of cases in which the Program lacked appropriate recourse under current law with respect to people on whom you have evidence of fraud, misrepresentation or other misdeed described in your testimony?

ANSWER 3:

The United States Trustee Program (USTP) has been very successful in identifying and civilly prosecuting instances of fraud and abuse. We do not define success, however, to mean that we uncover all instances of civil and criminal fraud in the bankruptcy system. Like other regulatory and enforcement agencies, we are not able to identify and investigate 100 percent of all potential violations. What is important is that the USTP, as the primary bankruptcy enforcement agency, develops, implements, and evaluates rigorous systems that uncover and prosecute fraud and abuse. Our work on this front ensures appropriate consequences for wrongdoers and provides a deterrent against similar bad conduct by others in the bankruptcy system.

We do not maintain data estimating the magnitude of fraud and abuse in the bankruptcy system.

We identify cases for action based upon current statutory standards. We do not maintain files on fraudulent and abusive cases we did not pursue.

QUESTION 4:

How many cases identified by the U.S. Trustee as constituting substantial abuse of ch. 7 could not be dismissed or converted under Sec. 707(b) as it now exists? Could you give some examples?

ANSWER 4:

We identify cases for action based upon current statutory standards. We do not maintain files on fraudulent and abusive cases that we do not pursue.

QUESTION 5:

Are there any provisions of this bill with which you disagree?

ANSWER 5:

As discussed in our testimony of March 4, 2003, with the exception of the fraud and abuse provisions of H.R. 975, the Department of Justice has no position on the overall bill or its other provisions.

QUESTION 6:

Sec. 102(h) of the bill provides that if a debtor cannot provide for the payment in full of an allowed unsecured claim, then the debtor must devote all of her disposable income in the first three years of the plan to make payments to unsecured creditors. Under current law, a debtor must show that she will pay all her disposable income in the first three years of the plan to pay any kind of debts. Do you believe that a debtor, including one with under median income, should be required to pay only general unsecured debts, and not be allowed to make up arrearage on a home or a car in the first three years of a plan? In order to confirm a ch. 13 plan a debtor must provide for payment in full of all priority unsecured debts. Do you believe that non-priority unsecured debts should be given this special new advantage to the detriment of the other creditors or the debtor's ability to keep a home or a car?

ANSWER 6:

The Department of Justice has no position on the provisions of Sec. 102(h) pertaining to payment of debts under a chapter 13 plan.

QUESTION 7:

Title XI of the bill concerns health care insolvencies. As a former ch. 7 trustee, do you have any concerns about how a trustee would perform all the duties required under this title in an administratively insolvent case?

ANSWER 7:

If H.R. 975 is enacted, we will work closely with the National Association of Bankruptcy Trustees and individual chapter 7 trustees whom we supervise to help ensure that these provisions are carried out appropriately. Health care insolvencies present unique challenges and the continued protection of patients and patient records is of paramount importance.

QUESTION 8:

In your testimony, you assert that you pursued more than "50,000 civil enforcement and related actions. . .that yielded approximately $160 million in debts not discharged and potentially available for distribution to creditors." Do you know how much of that $160 million was actually, not potentially, collectable or in fact collected? As you know, just because a debt is discharged doesn't mean the debtor would have ever been in a position to repay it.

ANSWER 8:

We do not have data showing the amount of non-discharged debt that is ultimately collected. The major purpose of the United States Trustee Program in bringing civil enforcement actions is to promote the integrity of the bankruptcy system, rather than to realize economic gain or loss for individual creditors or debtors.

QUESTION 9:

Do you believe that the Program receives sufficient funds to maintain the National Civil Enforcement Initiative at a level you would find acceptable? If not, how much should Congress provide to ensure full implementation?

ANSWER 9:

The United States Trustee Program has received sufficient levels of appropriations to carry out its mission. As with every agency, it is necessary to set priorities and to allocate resources accordingly. We have established civil enforcement as our top priority and have allocated resources in order to address this priority.

QUESTION 10:

Could you provide a section-by-section analysis of all the new duties that the U.S. Trustees and the private trustees will have should this bill pass, and itemize the cost, and number of additional FTEs required for each new function, such as audits, storage of additional paperwork, additional notices? For example, Sec. 102(c) of the bill requires the U.S. Trustee to:

- Review all materials filed by the debtor not later than 10 days after the 341 meeting,
- within 30 days file a motion to dismiss or file a statement setting forth the reasons why such a motion would be inappropriate,

- Sec. 603 requires the establishment of audit procedures for debtors. It requires that these audits be performed by Certified Public Accountants or Licensed Public Accountants, to perform the audits according to Generally Accepted Accounting Principles. You will be required to audit one in every 250 petitions. At a rate of 1.5 million and rising, that would be at least 6,000 GAAP audits performed by CPAs. Additionally, you are required to perform audits whenever there is an indication that there is some variance from the norm. How many audits would you likely perform annually, how much would each of these audits cost, and what would be the overall cost of the mandate?

- You would also be required to screen and evaluate the accountants and the providers of financial management training and credit counseling. Do you know how much these evaluations and oversight will cost?

ANSWER 10:

With regard to the new duties of United States Trustees under H.R. 975 and the costs of implementation, in August 2002, we provided such information to the House Appropriations Committee's Subcommittee on Commerce, Justice, State, the Judiciary and Related Agencies in response to a similar request and the relevant information is attached as a supplement. In the preparation of this data, passage of similar bankruptcy reform legislation was assumed to be September 30, 2002, with the effective date of March 31, 2003. Thus, the cost data is for only a six month period.

As Sec. 603 audits would not begin until the second year after the bill is signed into law, the attachment does not include a cost factor for implementing the audit provisions. The Program is still in the process of evaluating different audit protocols and, with the enormous number of variables involved in determining the scope and calculating the costs of such audits, has no reasonable basis at this point upon which to make reliable audit cost estimates. We would note that Sec. 603 gives the Attorney General authority to develop alternative auditing standards not later than two years after the date of enactment of H.R. 975.

With regard to private trustees, it is not possible to impute an objective cost to their new duties under H.R. 975 because it is not possible at this point to gauge how many cases would involve one or more of their new duties or to what degree. Moreover, private trustees are not compensated on a strict hourly basis. See 11 U.S.C. §§ 326, 328, and 330. The specific new private trustee duties in the legislation are:

Sec. 219. Collection of Child Support. Under Sec. 219, trustees in chapters 7, 11, 12, and 13 are given additional duties assisting creditors in collecting their claims for support. In every case involving a debtor who owes support, the trustee must, upon the filing, send a notice to the support creditor advising of the right to use a state agency to help collect support. The notice must include the name and address of the state agency for the state where the creditor lives. The trustee must also send a notice to the state agency, advising the agency of the name, address, and telephone number of the holder of the support claim. When the debtor receives a discharge, the trustee must send a notice to both the state agency and the holder of the claim. The notice must include (i) the last known address of the debtor; (ii) the last known name and address of the debtor's employer; and (iii) the names of other creditors in the cases whose debts were not discharged or were reaffirmed.

Sec. 1102. Disposal of Patient Records. A bankruptcy trustee with no funds to store patient records of a health care business may dispose of those records only if the trustee first gives patients and insurance carriers a 180-day notice that the records may be claimed. The trustee must then publish a notice in a newspaper of the right to claim the records at least one year in advance of destroying the records. After expiration of the one-year waiting period, the trustee must notify each appropriate federal agency of their right to claim the records before they are destroyed.

QUESTION 11:

Could you tell us what new costs new duties contained in this bill would impose on the private trustees? Do you anticipate any problems as a result of these costs?

ANSWER 11:

It is not possible to impute an objective cost to their new duties under H.R. 975 because it is not possible at this point to gauge how many cases would involve one or more of their new duties or to what degree. Moreover, private trustees are not compensated on a strict hourly basis. See 11 U.S.C. §§ 326, 328, and 330.

QUESTION 12:

It has been estimated that more than 95% of all ch. 7 cases are zero asset cases. Has anyone in your office performed a cost/benefit analysis to determine whether, given the costs of these new mandates, there will be a sufficient return for the estate and the creditors. I assume you agree that it is irrational to have a bankruptcy system that spends more to collect a debt then the total value of the debt, or the amount of debt which is both due and collectable, whether or not a discharge is granted.

ANSWER 12:

We have not performed the cost-benefit analysis described in this question. In part, such an analysis would require a definition of the term "sufficient." Although the United States Trustee Program exercises discretion in the civil enforcement actions it brings and makes prudential judgments regarding the devotion of resources to particular cases, our primary mission is to promote the integrity of the bankruptcy system. We believe that the United States Trustee Program was created by Congress to act as a neutral party that, unlike creditors and other participants in a bankruptcy case, takes actions for the benefit of the entire system, rather than the economic interests of any particular party.

3-10-03 7 p.m.

QUESTION 13:

There appear to be a great many duties and costs imposed on the U.S. Trustees, Bankruptcy Administrators, the private trustees, the courts, and the U.S. Attorneys to collect private debts. To what extent do you believe that the government should be expending public resources to hunt for assets or income in order to satisfy private debts. Do you think that there ought to be some duty on the part of the creditor to expend some resources to pursue its own debt, or do you believe that the U.S. Trustee program should become a collection agency for private parties such as credit card banks? How do you respond to Mr. Wallace's assertion that determining the availability of assets or income of a debtor or pursuing such issues in a 341 meeting or a 2004 examination are the job of the federal government and not the holders of claims. Are you concerned that this position would turn the U.S. Trustee Program into a governmental collection agency for private creditors? Do you believe this would be appropriate?

ANSWER 13:

The United States Trustee serves as a neutral party to represent the public interest by taking action to help ensure the expeditious administration of cases and the fair enforcement of the bankruptcy law. The United States Trustee Program does not, and should not, serve as a collection agency for a private party. Insofar as bankruptcy is a judicial process, however, it is critical that the United States Trustees serve as guardians to uphold the integrity of that process. Those who file false financial documents or otherwise abuse the bankruptcy laws should be held accountable. Our efforts to enforce the bankruptcy laws in no way vitiate the rights or obligations of creditors to protect their own interests, including by filing exceptions to discharge under 11 U.S.C. § 523, as appropriate.

QUESTION 14:

In terms of the integrity of the system, Sec. 102 of the bill imposes penalties, including disgorgement of fees and, in some cases, civil penalties and payment of fees to opposing parties, for debtor attorneys under certain circumstances. They have proved rather controversial, especially the requirement that debtor attorneys certify the accuracy of the information in the debtor's schedules. Do you believe these attorney liability provisions are appropriate? Do you have any concerns that they will prove inordinately burdensome, raise costs for debtors, or result in more pro se debtors?

ANSWER 14:

The Department of Justice has no position on the provisions of section 102 imposing new penalties on attorneys. We do note the important role of attorneys in ensuring the integrity of the bankruptcy process for debtors and creditors alike. Inadequate lawyering and submission of facially inaccurate schedules by attorneys and others evinces disrespect for the bankruptcy system and may lead to unnecessary time and expense by private trustees, creditors, and debtors who may engage in discovery or litigate issues that could have been resolved more efficiently if the bankruptcy petition, schedules, and statements of financial affairs had been prepared timely, completely, and accurately. An important feature of the National Civil Enforcement Initiative has been to identify and pursue attorneys and non-attorney petition preparers who prepare inadequate schedules.

In Fiscal Year 2002, we successfully took more than 2,300 formal and out-of-court actions and obtained almost $1.9 million in disgorged fees, fines, and penalties under 11 U.S.C. §§ 110 and 329.

QUESTION 15:

Do you believe that the same attorney liability rules should apply to creditor counsel? The bill only provides for the payment of opposing party's costs, even in cases where Rule 9011 has been violated. Also, an entire class of creditors and their attorneys cannot be penalized under this provision even if they are found to have violated Rule 9011, which prohibits, among other things, presenting any document to the court that is "presented for any improper purpose, such as to harass or to cause unnecessary or needless increase in the cost of litigation" as well as the requirements that the legal positions and factual assertions are backed by a reasonable reading of the law and proper evidentiary support. Do you believe that any party in a case should be exempted from any penalty for having done these things?

ANSWER 15:

The Department of Justice has no position on the provisions of H.R. 975 pertaining to liability of counsel.

QUESTION 16:

After all the scandals involving conflicts of interest on the part of financial advisors, investment bankers, accountants, and other entities, how do you justify Sec. 414, which repeals the requirement that investment bankers must be "disinterested persons" in order to work as professionals in the case? How do you justify Sec. 324 which overturns the *Merry-go-round* case by limiting the ability of an aggrieved party to seek redress against accountants who have engaged in some improper conduct in the case?

ANSWER 16:

The Department of Justice has no position on the provisions of H.R. 975 pertaining to amendments to the definition of "disinterested person" and standards for liability of professionals employed in a bankruptcy case.

QUESTION 17:

During the period 1994 to the present:

- How much did household debt increase?
- How much did consumer credit outstanding increase?
- How much did the annual number of credit card solicitations increase?

ANSWER 17:

The United States Trustee Program does not collect or maintain the data requested.

Supplement to Question 10 Response

Summary of Potential Changes Resulting from Bankruptcy Reform Legislation

Means Testing

Under current law, the United States Trustee may seek to dismiss a consumer chapter 7 case for "substantial abuse." 11 U.S.C. § 707(b). The legislation substitutes an abuse standard based in part upon the concept of means testing. Under means testing, a chapter 7 consumer filing will be "presumed abusive" if the debtor's current monthly income, minus certain expenses, would allow the debtor to repay between $6,000 and $10,000 to unsecured creditors over a five-year period. Expenses will in large measure be based on IRS guidelines instead of the debtor's actual expenses. A debtor may rebut the presumption of abuse by demonstrating special circumstances that justify additional expenses or adjustments to income.

The means testing provision will add new duties for the Program. The legislation requires the United States Trustee to review all materials filed by an individual debtor in a chapter 7 case and file a statement with the court no later than ten days after the meeting of creditors stating whether the case is presumed abusive. Within 30 days after filing a statement that a case is presumed abusive, the United States Trustee must either file a motion to dismiss or convert the case or file another statement explaining why the United States Trustee does not believe such a motion is appropriate. The legislation would also apply means testing to chapter 13 proceedings, requiring debtors to turn over all of their "disposable income" as defined under the means test. The initial review and preparation of statements, and the subsequent investigation and litigation of cases presumed abusive, will require significant resources.

Credit Counseling

The legislation adds a new provision requiring all individuals to attend a credit counseling session before they file for bankruptcy relief. The United States Trustee is required to approve credit counseling agencies in every district.

The United States Trustee must "thoroughly review" a credit counseling agency's qualifications before approving it, and the legislation provides a list of minimum standards, including:

- the agency must be a nonprofit organization;
- any fees charged must be reasonable;
- the agency must provide for the safekeeping of funds, and provide for annual audits and employee bonding;
- the agency must provide full disclosures to its clients;
- the agency must provide adequate counseling;
- the agency must provide trained counselors who receive no commissions or bonuses;

– the agency must demonstrate adequate experience and background; and
– the agency must have adequate financial resources.

Certification presents a number of challenges because the credit counseling industry is generally unregulated. Even if carried out with great care and prudence, certification decisions will be difficult and may be subject to litigation.

Debtor Education

The legislation requires all chapter 7 and chapter 13 debtors to attend a debtor education program after they file bankruptcy as a condition of discharge. As in the credit counseling area, the United States Trustee is required to approve agencies conducting debtor education programs in every district. Further, within 270 days after enactment of the legislation, the EOUST must conduct a debtor education pilot project in six judicial districts for a period of 18 months, and then evaluate its effectiveness.

Standards for the approval of providers cover four elements – personnel, teaching materials and methods, facilities, and record-keeping – and each has specific requirements. Experts in the education field will be contracted with to assist in implementation of this provision.

Debtor Audits

The legislation requires the Attorney General to establish procedures to determine the "accuracy, veracity, and completeness" of a debtor's schedules in chapters 7 and 13. Under these procedures, United States Trustees must contract with qualified persons to conduct a random audit of at least 1 out of 250 (0.4%) debtors in each judicial district and to audit all debtors whose income and expenses reflect "greater than average variances from the statistical norm of the district." The estimated number of audits needed may be as high as 13,000 nationwide.

Small Business Provisions

The legislation adds a number of new provisions primarily applicable to small business chapter 11 cases to strengthen the United States Trustee's ability to ensure they do not languish in bankruptcy. The legislation also adds a section governing individual chapter 11 bankruptcies. The new provision states that post-petition earnings are now property of the estate, and therefore this asset must be considered in determining whether a chapter 11 plan complies with the requirements for confirmation.

"Due Process" Provision

The legislation also provides due process protections to a trustee who is suspended or terminated by a U.S. Trustee, and to a chapter 12 or 13 standing trustee whose request for reimbursement of an expense has been denied. Under this provision, an aggrieved trustee may seek review by a United States District Court, after the trustee has exhausted administrative remedies. These remedies may include, at the election of the trustee, a formal administrative hearing on the record. The final decision of the agency must be affirmed by the District Court unless the decision is "unreasonable and without cause."

Reestimate of Bankruptcy Reform Legislation

Item	Positions	Workyears	Amount
Attorneys	116	58	$9,690,903
Bankruptcy Analysts	95	48	$6,399,548
Paralegals	67	34	$2,597,607
Legal Clerks	93	47	$3,351,923
Analysts	3	2	$202,091
Financial Mgt. Test Pgm.	...	...	$2,700,000
Debtor Education	...	...	$500,000
Small Business Visits	...	...	$161,500
Information, Collection, Analysis and Reporting	...	...	$1,350,000
Total	**374**	**189**	**$26,953,572**

March 6, 2003

Lucile P. Beckwith
President & Chief Executive Officer
Palmetto Trust Federal Credit Union
c/o John J. McKechnie, III
Senior Vice President of Governmental Affairs
Credit Union National Association, Inc.
601 Pennsylvania Avenue, NW
Washington, DC 20004

Dear Ms. Beckwith:

Thank you for appearing before the Subcommittee on Commercial and Administrative Law at the hearing on H.R. 975, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2003," and the need for bankruptcy reform on March 4, 2003. Your testimony, and the efforts you made to present it, are deeply appreciated and will help guide us in whatever action we take on the issue.

Pursuant to the unanimous consent request agreed upon at the hearing, Subcommittee Members were given the opportunity to submit written questions to the witnesses. Questions submitted by the Minority for your written response are annexed. Your response will help inform subsequent legislative action on this important topic.

Please submit your written response to these questions by 5:00 p.m. on Wednesday, March 12, 2003, to: Susan Jensen, Subcommittee on Commercial and Administrative Law, B353 Rayburn House Office Building, Washington, DC 20515. Your responses may also be submitted by e-mail to susan.jensen@mail.house.gov. If you have any questions, feel free to contact Ms. Jensen at (202) 225-2825. Thank you for your continued assistance.

Sincerely,

CHRIS CANNON
Chairman
Subcommittee on Commercial and Administrative Law

CC: sj

ONE HUNDRED EIGHTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON THE JUDICIARY

2138 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6216
March 6, 2003
http://www.house.gov/judiciary

Hon. Chris Cannon
Chairman
Subcommittee on Commercial and
Administrative Law
B-353 Cannon House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Attached, please find additional questions submitted pursuant to the unanimous consent request adopted at our hearing on bankruptcy legislation held on Tuesday, March 4, 2003. We believe that these questions are directly relevant to the matter under consideration and reflect members's concerns.

Should you, or any of the witnesses, have any questions concerning this matter, please do not hesitate to contact us.

Thank you for your consideration in this matter and for your willingness to accommodate our concerns. Please also extend once again our gratitude to the witnesses for their cooperation.

Sincerely,

John Conyers, Jr.
John Conyers, Jr.
Ranking Member
Committee on the Judiciary

Melvin L. Watt
Melvin L. Watt
Ranking Member
Subcommittee on Commercial and
Administrative Law

Jerrold Nadler
Jerrold Nadler
Ranking Member
Subcommittee on the Constitution

QUESTIONS FOR LUCILE BECKWITH
CREDIT UNION NATIONAL ASSOCIATION

- According to James Blaine, CEO of the NC State Employees Credit Union, "Charge-offs, too, are well under control at .46% of total loans (less than 1%). In other words, 99.5% of credit union loans are repaid as promised. According to NCUA 41.1% of credit union charge-offs related to bankruptcy. Or said another way, just .19% (less than 2/10thof 1%!) of total credit union loans result in a bankruptcy loss." So taking a the high estimate of 15% rate of abuse, he calculates that total losses on loan portfolios are .0385% or less than 3/100ths of 1% (.19% x 15% = .0285% (less than 3/100ths of 1%). Jim Blaine, 'Only Thing Bankrupt Is Logic Behind 'Reform' *Credit Union Journal* 23 (February 24, 2003).

- The one provision we have been told in negotiations is a 'deal breaker' for the credit unions is in the title on reaffirmation agreements. The bill provides that the court may reject a reaffirmation agreement if it would cause undue hardship, which is, astonishingly, defined as requiring payments in excess of the debtor's disposable income. Even more astonishingly, credit unions are exempt from this pathetic restriction on reaffirmations. Can you justify stripping a bankruptcy court of the ability to reject, under any circumstances, a reaffirmation agreement that would require a debtor to pay more than their total disposable income? Is this really a deal breaker for the credit unions or would approve of the Committee placing them under the same rules that apply to all other creditors?

- In many cases, credit unions cross-collateralize their credit card debt with secured debt so that a debtor would not be able to keep the family car even if they continue to make payments if they also discharge the credit card debt. With the elimination of cram-down, this would mean that a debtor would be required to repay the secured portion and the unsecured portion of a car loan, plus, potentially all outstanding credit card debt owed to the credit union. What benefit does the honest and truly deserving debtor receive in bankruptcy if these are the rules?

- You cited a number of instances in your testimony in which a borrower made what appear to have been profligate purchases prior to bankruptcy. As part of your credit card agreements do you place any restriction on what a card holder may purchase or only on the line of credit? If there are no restrictions on the purchases, what is the relevance of the type of purchases absent evidence that there was an intent to defraud or not to repay? Would some of these spending patterns better be addressed through member education than changes to the Bankruptcy Code?

- Do you believe that government, rather than the lender, should spend public funds to investigate the financial situation of a borrower?

– Could you provide data on extent to which the members of your organization lend to post-bankruptcy individuals, broken down by chapter 7 and chapter 13.

-- During the period 1994 to the present:

- How much did household debt increase?
- How much did consumer credit outstanding increase?
- How much did the annual number of credit card solicitations increase?

RESPONSES TO FOLLOW-UP QUESTIONS FROM MARCH 4, 2003, HEARING ON H.R. 975, THE BANKRUPTCY ABUSE REFORM AND CONSUMER PROTECTION ACT OF 2003 BEFORE THE HOUSE JUCIARY SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW FOR LUCILE BECKWITH CREDIT UNION NAITONAL ASSOCIATION

1. The first question refers to an article by James Blaine in the February 24, 2003, edition of *The Credit Union Journal* and a number of statistics he cites in supporting his theory that H.R. 975 would not have a significant impact on reducing the number of bankruptcy filings at credit unions. First, I am a good friend of Jim and have discussed this issue with him a number of times, and I have told him each time that I think he is wrong. I have submitted for the record already an article in the same edition that I wrote outlining some of my own conclusions. While the statistics Jim cites may be accurate for his credit union, they are not accurate for credit unions as a whole. As mentioned in my written testimony, bankruptcy filings accounted for about 46 percent of all credit union losses in 2002. National studies suggest that from 3-15 percent of all bankruptcy filings are abusive, and that likely varies from one institution to another. And regardless of the statistics, this bill should have an impact beyond what may be quantified. We strongly support the educational components of the bill and believe that they may help reduce bankruptcy filings of all kinds over a longer period of time. We also feel that the bill will send a strong signal that people need to be more responsible for their actions and the impact they have on others, and that this, too will have long-term implications.

2. Below is the copy of the text of a letter already submitted in response to this question during the hearing:

The Honorable Chris Cannon
Chairman
House Judiciary Subcommittee on Commercial
and Administrative Law
B-353 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Cannon:

Thank you for your gracious remarks and respectful treatment at yesterday's hearing on bankruptcy abuse reform. It was indeed a privilege for me to volunteer my time on behalf of the Credit Union National Association (CUNA) to assert my Constitutional right to petition my government.

The purpose of this letter is to respond to the request of me by one of the Subcommittee members regarding CUNA's position on the reaffirmation provisions in H.R. 975. I was asked whether CUNA would agree to an amendment to require credit unions to comply with the more cumbersome reaffirmation requirements in the bill. **Let me make it perfectly clear that CUNA would strongly oppose any amendment or bill designed to require more difficult reaffirmation procedures for credit unions and their members who wish to voluntarily reaffirm their debts.**

You may recall that this provision is already a product of compromise. The original House bill totally exempted credit unions from its reaffirmation provisions. These provisions were modified in conference in response to the Senate's insistence. Ultimately, Congress recognized that credit unions and their members have a special relationship with each other and that in a credit union, this relationships results in protecting the members' rights to voluntarily reaffirm their debts. This ensures that the member has continued access to reasonably priced products and services. Without the ability to voluntarily reaffirm with their credit union, many members would be forced to seek credit from high-priced credit grantors, which could charge as much as 25 percent or more for loans.

Reaffirmations save the credit union and all of its members from suffering losses, which would otherwise have to be picked up by each member. This keeps costs down for the credit union and its members. In addition, the credit union works with the member to help repair their credit history and to avoid future financial problems. This is consistent with the credit union philosophy of "People Helping People."

I would appreciate it if you would distribute this response to the rest of the Subcommittee and make it a part of the hearing record.

I would also like to submit for the hearing record the enclosed copies of the two surveys referred to in my written testimony, as well as a copy of my response in the same edition of the *Credit Union Journal* to the Jim Blaine article submitted at yesterday's hearing.

Thank you again for the opportunity to provide the Subcommittee with CUNA's views on the need to pass bankruptcy abuse reform legislation as soon as possible.

Sincerely,

Lucile P. Beckwith
President/CEO
Palmetto Trust Federal Credit Union

Encls.

3. Question number 3 refers to the cram-down provisions in the bill and credit union cross-collateralization of credit card debt. The benefit in this scenario is the same benefit the debtor receives from the credit union if he reaffirms his debts - the continued full range of services from his credit union. There is no question that the credit union will offer better rates than the debtor who turns to a used car dealer for financing another automobile and to other non-depository institution lenders for extensions of future unsecured credit. Credit unions work both with members who are falling behind in payments and members who file for bankruptcy. A key reason CUNA continues to support bankruptcy reform efforts is the inclusion of financial education provisions to address the need for consumers to understand the responsibilities of borrowing money.

4. In question number 4, you inquire about the examples of abusive filings at my credit union. We restrict only the amount of the line of credit. There are no restrictions on what a cardholder purchases. I don't see how purchase restrictions would prevent fraudulent practices. Member education will help honest members be able to handle their finances with more personal accountability and understanding of financial processes. However, education will not help members who rationalize that taking advantage of the loopholes in the current bankruptcy law is acceptable because it is "perfectly legal" to do so. The bankruptcy code must be changed to stop people from dishonest and unethical - though "perfectly legal" - practices.

5. In question 5 you ask if I believe that the government, rather than the lender, should spend public funds to investigate the financial situation of a borrower. On the one hand, if the person is using bankruptcy in a dishonest way then I think the bankruptcy court has an obligation to protect its own reputation by investigating (using public funds) the financial situation of the borrower. On the other hand, there is no doubt that financial institutions have the duty and responsibility to carry out this role to ensure that they are not taking on too much risk and that they are doing as much as possible to extend credit where it is appropriate. Unfortunately, it is not always possible to uncover a dishonest or abusive filer.

6. Regarding your request for data on the extent to which credit unions in general lend to post-bankruptcy individuals, broken down by Chapter 7 and Chapter 13, CUNA does not have access to such information for credit unions on a nationwide basis. And regarding Palmetto Trust, we don't track these loans so I have no way to provide data.

7. You ask for a variety of data from 1994 to the present:

a. How much did household debt increase?
   According to the Federal Reserve Flow of Funds, household debt increased from $4.17 trillion at year-end 1994 to $7.81 trillion at year-end 2002. This is a $3.64 trillion (87%) increase.

b. How much did consumer credit outstanding increase?
According to the Federal Reserve Flow of Funds, consumer credit increased from \$0.98 trillion at year-end 1994 to \$1.76 trillion at year-end 2002. This is a \$0.77 trillion (79%) increase.

c. How much did the annual number of credit card solicitations increase?
According to Synovate, credit card companies sent a record 5 billion credit card solicitations in 2001(that translates to roughly 4 per household per month). The company news releases that contain data through third quarter 2002, suggest that the 2002 total will be very close to the 2001 total of 5 billion solicitations.

March 6, 2003

Judith Greenstone Miller, Esq.
Raymond & Prokop, P.C.
26300 Northwestern Highway, 4th Floor
P.O. Box 5058
Southfield, MI 48086-5058

Dear Ms. Miller:

Thank you for appearing before the Subcommittee on Commercial and Administrative Law at the hearing on H.R. 975, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2003," and the need for bankruptcy reform on March 4, 2003. Your testimony, and the efforts you made to present it, are deeply appreciated and will help guide us in whatever action we take on the issue.

Pursuant to the unanimous consent request agreed upon at the hearing, Subcommittee Members were given the opportunity to submit written questions to the witnesses. Questions submitted by the Minority for your written response are annexed. In addition, I request that you respond to the following questions:

> On March 18, 1998, you testified before this very Subcommittee about the impact of the legislation's consumer proposals on unsecured creditors. You stated as follows: "The League believes that the adoption of many of the consumer proposals contained in H.R. 3150 and H.R. 2500 [predecessors to H.R. 975] will enhance the rights of unsecured creditors. Reform is appropriate in circumstances where abuse has been prevalent, such as (1) when debtors incur debts on the eve of bankruptcy when they are clearly insolvent, in financial distress or in all likelihood unable to pay for the goods or services, or (2) when debtors obtain advances and such funds are used to extinguish priority or nondischargeable claims." You further added, "CLLA believes that those two bills provide a more balanced and equitable approach to the very real and troubling financial problems being faced by consumers today." Your prepared statement concluded with the following statement: "The CLLA generally believes that many of the consumer specific provisions contained in H.R. 3150 will benefit creditors and as detailed above should be enacted into law." Indeed, you criticized bankruptcy legislation introduced by Mr. Nadler as H.R. 3146 during the course of that hearing.
>
> > Why do you now oppose H.R. 975, a bill that contains many of the provisions that included in legislation with respect to which you previously testified in support of before this Subcommittee during

the 105th Congress?

One of the points you made in your prepared testimony for the March 4, 2003 hearing is that the legislation is "neither fair nor practically sound." Is it your position now that the current legislation should revert to the reforms proposed in H.R. 2500 and H.R. 3150 that were under consideration during the 105th Congress?

Your response to these questions will help inform subsequent legislative action on this important topic. Please submit your written response by 5:00 p.m. on Wednesday, March 12, 2003, to: Susan Jensen, Subcommittee on Commercial and Administrative Law, B353 Rayburn House Office Building, Washington, DC 20515. Your responses may also be submitted by e-mail to susan.jensen@mail.house.gov. If you have any questions, feel free to contact Ms. Jensen at (202) 225-2825. Thank you for your continued assistance.

Sincerely,

CHRIS CANNON
Chairman
Subcommittee on Commercial and Administrative Law

CC: sj

ONE HUNDRED EIGHTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON THE JUDICIARY

2138 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515–6216

(202) 225-3951 March 6, 2003

http://www.house.gov/judiciary

Hon. Chris Cannon
Chairman
Subcommittee on Commercial and
Administrative Law
B-353 Cannon House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Attached, please find additional questions submitted pursuant to the unanimous consent request adopted at our hearing on bankruptcy legislation held on Tuesday, March 4, 2003. We believe that these questions are directly relevant to the matter under consideration and reflect members's concerns.

Should you, or any of the witnesses, have any questions concerning this matter, please do not hesitate to contact us.

Thank you for your consideration in this matter and for your willingness to accommodate our concerns. Please also extend once again our gratitude to the witnesses for their cooperation.

Sincerely,

John Conyers Jr.

John Conyers, Jr.
Ranking Member
Committee on the Judiciary

Melvin L. Watt
Ranking Member
Subcommittee on Commercial and
Administrative Law

Jerrold Nadler

Jerrold Nadler
Ranking Member
Subcommittee on the Constitution

QUESTIONS FOR JUDITH MILLER
DEMOCRATIC WITNESS
COMMERCIAL LAW LEAGUE OF AMERICA

- Mr. Wallace says that everyone opposed to the bill does so because they have a stake in the system. He also dismisses the American Bankruptcy Institute as "pro-debtor." In addition to your organization, the National Bankruptcy Conference, most bankruptcy judges, many ch. 7 and ch. 13 trustees, nearly all the nation's bankruptcy law professors, as well as creditor lawyers like you, have strongly criticized the bill. Why do you think there is such a broad consensus among the nation's leading bankruptcy experts that this bill is a bad idea.

- Much of the debate has been centered whether this bill is pro- or anti- debtor. How would this bill alter the rights of different creditors? Could you identify particular special-interest provisions that would grant new, disproportionate rights to particular creditor interests?

- To what extent would this bill lead to the failure of potentially successful ch. 11 reorganizations? What would be the impact on jobs, trade creditors, and the economy in general?

- To what extent should the government expend funds to pursue claims or investigations on behalf of creditors? To what extent should the market place (that is to say, a cost benefit analysis of the cost of collecting the debt versus the value of the debt) decide the manner in which it is pursued?

March 11, 2003

Hon. Chris Cannon
Chairman of the United States House of Representatives
Committee on the Judiciary
Subcommittee on Commercial and Administrative Law
2138 Rayburn House Office Building
Washington, DC 20515-6216

Re: United States House of Representatives
Judiciary Committee
Subcommittee on Commercial and Administrative Law
Hearing on Bankruptcy Abuse Prevention and Consumer Protection Act of 2003 and the Need for Bankruptcy Reform
March 4, 2003

Dear Representative Cannon:

Thank you for inviting the Commercial Law League of America ("CLLA") to testify as a witness before the House Judiciary Committee, Subcommittee on Commercial and Administrative Law, at the hearing held last week. We received your written inquiries of March 6, 2003, regarding our testimony before the Subcommittee on Commercial and Administrative Law.

It is unfortunate that mark-up is scheduled to take place even before the answers to the specific inquiries proffered by the Subcommittee to the witnesses are due to be submitted, thereby suggesting that the substantive responses will be given little or no weight in consideration of the legislation. Nonetheless, we have prepared our formal response to the Subcommittee's inquiries and hope they will be given careful consideration as part of the proposed legislation and the Subcommittee's concern over the need for bankruptcy reform. The CLLA has been and remains committed to working with Congress in achieving meaningful bankruptcy reform.

In your March 6th letter, you posed two important questions, both of which appear premised on the following:

> On March 18, 1998, you testified before this very Subcommittee about the impact of the legislation's consumer proposals on unsecured creditors. You stated as follows: "The League believes that the adoption of many of the consumer proposals contained in H.R. 3150 and H.R. 2500 [predecessors to H.R. 975] will enhance the rights of unsecured creditors. Reform is appropriate in circumstances where abuse has been prevalent,

such as (1) when debtors incur debts on the eve of bankruptcy when they are clearly insolvent, in financial distress or in all likelihood unable to pay for the goods or services, or (2) when debtors obtain advances and such funds are used to extinguish priority or nondischargeable claims." You further added, "CLLA believes that those two bills provide a more balanced and equitable approach to the very real and troubling financial problems being faced by consumers today." Your prepared statement concluded with the following statement: "The CLLA generally believes that many of the consumer specific provisions contained in H.R. 3150 will benefit creditors and as detailed above should be enacted into law." Indeed, you criticized bankruptcy legislation introduced by Mr. Nadler as H.R. 3146 during the course of the hearing.

You then asked two specific questions, each of which is set forth below with our response.

Question 1

Why do you now oppose H.R. 975, a bill that contains many of the provisions that included (sic) in legislation with respect to which you previously testified in support before this Subcommittee during the 105th Congress?

Response

The CLLA has consistently acknowledged that there have been abuses by some individual and business debtors seeking relief under the Bankruptcy Code "("Code"). Such abuses by the "few," however, should not be utilized to craft legislation that will penalize those debtors worthy and in need of financial relief. Moreover, the CLLA has been supportive of various specific provisions in the various bills since the 105th Congress as providing needed reforms and curbing abuse, such as making Chapter 12 permanent. Much needed and well-acknowledged reforms have been held hostage as placeholders with the hope of using them to ensure passage of the overall legislation.

The statements from our March 18, 1998, testimony that you quote in your letter, however, create an inaccurate perception of the extent to which the CLLA supported either H.R. 3150 or H.R. 2500 as introduced. Moreover, although H.R. 975 may contain some provisions similar to those initially proposed in H.R. 3150 and H.R. 2500, H.R. 975 is, nevertheless, a substantially different piece of legislation.

As you correctly note, our 1998 testimony expressed the CLLA's support for reform in certain limited circumstances where abuse is prevalent. Toward that end, we testified in support of specific provisions the CLLA believed would prevent debtors from making strategic use of the Code to the detriment of creditors. One such provision was an early attempt by Congress to curb abusive use of the homestead exemption by affluent debtors. The CLLA was then, and remains, committed to a Code amendment that prevents wealthy debtors from establishing residence in states with generous homestead exemptions and allowing them to shield vast fortunes from their creditors.

Another example is the "anti-cramdown" provision found in Section 128 of H.R. 3150 and Section 110 of H.R. 2500. The CLLA supported these provisions, precluding Chapter 13 debtors from stripping down liens on personal property acquired within 180 days of filing the bankruptcy petition. Although the CLLA had expressed some concern about the arbitrariness of selecting 180 days as the benchmark for abuse, we nevertheless agreed with the general tenor of the provision because fairness dictates that the debtor assume the burden of depreciation on property acquired on the eve of a bankruptcy filing.

When the Conference Report on H.R. 3150 emerged in late 1998, however, this provision was so substantially changed, from 180 days to five years, that it was no longer tenable because of the significant negative impact it would have on general unsecured creditors. Not only is it difficult to sustain a presumption of abuse where property was acquired so long before a bankruptcy petition is filed, but also the extended time period worked a hardship on unsecured creditors. Furthermore, there is no legal or other basis to justify enhancing secured creditors' rights merely by virtue of a bankruptcy filing when this class of creditors clearly would not have such rights outside bankruptcy under Article 9 of the Uniform Commercial Code.

Indeed, one study concluded that, using the five year period, unsecured creditors would lose more than $100 million annually in Chapter 13 payments. The CLLA is unaware of studies showing the cost attributable to the changed time periods under H.R. 975 (910 days if the collateral is a motor vehicle and one year for other property), but that time period still appears to be too long to presume abuse and to grant an enhancement to such creditors to the detriment of unsecured creditors generally. As stated, a presumption of debtor abuse cannot be sustained beyond a limited timeframe and the provision ultimately requires unsecured creditors to subsidize a benefit secured creditors would not be entitled to under state law. Accordingly, as currently proposed, the CLLA cannot support this provision.

In 1998, the CLLA supported a provision that would preclude a debtor from using a credit card or other form of dischargeable debt to pay a debt that would be nondischargeable in bankruptcy. This provision was directed toward, for example, making a debtor's use of a cash advance from his credit card to pay off the balance of his student loans nondischargeable. The CLLA supported such a provision on notions of fairness to creditors and, again, to prevent debtors from engaging in strategic, pre-bankruptcy behavior. The CLLA did, however, express concern at the time of the 1998 hearing that no time period was provided in the legislation regarding the scope and application of this provision.

H.R. 975 does not provide this exception to discharge. However, this change could have been prompted by concerns expressed by other groups regarding the expansion of nondischargeability. Most notably, advocates for support recipients have argued that by expanding the class of nondischargeability, Congress is putting support recipients in competition with institutional creditors for the debtor's postpetition income stream. What has emerged from this opposition are two compelling, yet competing, policy considerations and a potential consequence of bankruptcy reform that Congress had not fully considered when H.R. 3150 and H.R. 2500 were first introduced.

At the 1998 hearing, we also expressed the concerns of the CLLA regarding the means test, indicating our belief that an inflexible fixed formula was not an appropriate mechanism for weeding out abusive bankruptcy filings. We reiterated these concerns in testimony given on March 11, 1999. The position of the CLLA, as expressed in our testimony of March 4, 2003, is no different; the means test is not practically sound, nor is the concept of fairness properly expressed in legislation that presumes abuse on the part of every consumer debtor who seeks Chapter 7 relief. In fact, in 1999, we reaffirmed our concerns with respect to the means test and other consumer provisions, as indicated in the attached copy of my testimony.

With respect to H.R. 3146, the CLLA stands by its opposition to that bill introduced in the 105th Congress because it, too, failed to strike an appropriate balance between debtors' rights and creditors' remedies. However, Congressman Nadler, the sponsor of H.R. 3146, did recognize that a different approach to bankruptcy reform may be warranted, and the CLLA acknowledged the value of his efforts in the 106th Congress. A similar fresh approach is warranted now, especially in light of the changed conditions of our economy.

Finally, and of critical importance, the 1998 hearing addressed only consumer provisions of bankruptcy reform. Unlike H.R. 2500, H.R. 3150 amended the Code in a variety of ways that would affect business bankruptcy cases. Most notable among these amendments is the "fast track" Chapter 11 procedure for small business debtors that the CLLA has opposed from the outset, consistent with our attached testimony of March 18, 1999. We note the modest improvement Congress has made to this procedure over the years - a "small business debtor" is defined in H.R. 975 by reference to a $2 million debt ceiling rather than the $5 million in debt H.R. 3150 initially proposed - but we nevertheless believe that, on the whole, the small business provisions will force the premature liquidation of viable businesses. The result will be diminished recovery for unsecured creditors, loss of tax bases, lost jobs, and loss of going concern value of often viable companies.

Question 2

One of the points you made in your prepared testimony for the March 4, 2003 hearing is that the legislation is "neither fair nor practically sound." Is it your position now that the current legislation should revert to the reforms proposed in H.R. 2500 and H.R. 3150 that were under consideration during the 105th Congress?

Response

The CLLA does not believe Congress should merely revert to a bill that is substantially similar to either H.R. 3150 or H.R. 2500, both of which were introduced in the 105th Congress. As the CLLA has previously stated, these bills were defective in important respects, especially as they concern business bankruptcy cases. The better approach to achieving balanced and meaningful bankruptcy reform is to reexamine the legislation in light of the current conditions. As always, the CLLA stands at the ready to assist Congress in this regard.

The passage of time has changed the context within which bankruptcy reform has been considered in two very important respects. The first is the development of a body of studies and scholarly work regarding the implications and assumptions of bankruptcy reform. All those with an interest in truly reforming the Code, including the CLLA, are now better informed regarding the specific provisions considered in H.R. 975 or past versions of bankruptcy reform, as well as the need for reform in areas the bankruptcy reform legislation has never properly addressed.

Second, our world is vastly different today than it was in 1998. One of the underlying assumptions of bankruptcy reform was the presumption that an unacceptable level of abuse must be driving the high number of bankruptcy filings during a time of unprecedented peace and prosperity.

In 2003, we have neither peace nor prosperity. Americans are now plagued by uncertainty regarding the economy and the prospects for war. A significant recession began in the beginning of 2001 and continues today; its effects were only exacerbated by the terrorist attacks of September 11th and the fall of such corporate giants as Enron, K-Mart and WorldCom, many of which have been plagued with fraud and misconduct. Thousands of jobs and millions of retirement accounts have fallen with them. As we indicated in our testimony of last week, military Reservists called to active service and their families are facing significant hardship, as highlighted in the attached front page *Washington Post* article of March 4th.

Consumer confidence has dropped to a near decade low. Individuals have seen their investments decline dramatically as the stock market lost over 30 percent of its value, while the safety of a federally insured bank account yields them no return because of the historically low interest rates. Moreover, while low interest rates have helped consumers purchase homes and cars, no respite was forthcoming from their credit card issuers, who have failed to pass on the lower rates to consumers, instead choosing to reap enormous profits for themselves.

Ironically, the total consumer filings in 2002 (1,539,111) were not significantly higher than in 1998 (1,398,182), and non-business filings declined in both 1999 and 2000. Thus, the fears expressed in the 105th Congress, namely that the tide of filings must be stemmed before an economic downturn causes bankruptcies to spiral out of control, have not occurred. Nor have small businesses turned to bankruptcy in alarming numbers despite the uncertainty caused not only by the general recession, but also by the loss of business from their bankrupt customers such as Consolidated Freightways, K-Mart, or the financially distressed airline industry.

Bankruptcy reform simply must take account of today's reality rather than continuing to rest on assumptions formed in remarkably different times. Abuse must surely be remedied, but it is first necessary to distinguish with greater precision the abusers from those in genuine need of relief. Only then can reform proceed in a manner that not only protects the integrity of the bankruptcy system, but which also does not unduly chill such vital economic interests as consumer spending and entrepreneurship.

Conclusion

Prior to enacting legislation that will create sweeping changes, at a time when financial relief is likely to be needed the most, Congress must pause, take a step back, and carefully analyze and reexamine that which it has proposed against the current realities and needs of the system for debtors and creditors alike. Sweeping reform that imposes barriers to bankruptcy relief for those truly in need to weed out the relatively few abusers simply swings the pendulum too far.

The CLLA appreciates the opportunity to respond to your inquiries and, as always, we look forward to working with Congress in achieving meaningful, balanced and effective bankruptcy reform.

Respectfully submitted,

Judith Greenstone Miller

Co-Chair, National Governmental Affairs Committee
Chair, Bankruptcy Section
Commercial Law League of America

Jay L. Welford

Co-Chair, National Governmental Affairs Committee
Co-Chair, Legislative Committee
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cc: John P. Wanderer
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March 11, 2003

Hon. John Conyers, Jr.
Hon. Melvin L. Watt
Hon. Jerrold Nadler
United States House of Representatives
Committee on the Judiciary
Subcommittee on Commercial and Administrative Law
2138 Rayburn House Office Building
Washington, DC 20515-6216

Re: United States House of Representatives
Judiciary Committee
Subcommittee on Commercial and Administrative Law
Hearing on Bankruptcy Abuse Prevention and Consumer Protection Act of 2003 and the Need for Bankruptcy Reform
March 4, 2003

Gentlemen:

Thank you for inviting the Commercial Law League of America ("CLLA") to testify as a witness before the House Judiciary Committee, Subcommittee on Commercial and Administrative Law, at the hearing held last week. We received your written inquiries of March 6, 2003, regarding our testimony before the Subcommittee on Commercial and Administrative Law. The CLLA has been and remains committed to working with Congress in achieving meaningful bankruptcy reform.

Question 1

Mr. Wallace says that everyone opposed to the bill does so because they have a stake in the system. He also dismisses the American Bankruptcy Institute as "pro-debtor." In addition to your organization, the National Bankruptcy Conference, most bankruptcy judges, many ch. 7 and ch. 13 trustees, nearly all the nation's bankruptcy law professors, as well as creditor lawyers like you, have strongly criticized the bill. Why do you think there is such a broad consensus among the nation's leading bankruptcy experts that this bill is a bad idea.

Response

That opponents, or supporters for that matter, have a stake in the bill is little more than a red herring. It is axiomatic that having a stake in the outcome of any piece of legislation is the driving force behind an individual or organizational response to that legislation, be it for or against. The CLLA has consistently advocated for balanced bankruptcy legislation that works for all parties in interest because it is the integrity of the system that is of paramount concern.

As you correctly point out, however, the breadth of opposition to bankruptcy reform is rather remarkable, and the opinions of bankruptcy judges, trustees, and academics cannot all be dismissed as "pro-debtor" or motivated purely by self-interest. Rather, these opponents have considered the many provisions of bankruptcy reform in the context of their own experience with and understanding of the system and the impact that the legislation is likely to have on the system.

For example, it was a Chapter 13 trustee, Hank Hildebrand, who provided insight as to the cost of the "anti-cramdown" provision similar to Section 306(b) of H.R. 975. Although the American Bankruptcy Institute does not take official positions on legislation, it provided funding for studies so that data available on debtors' "ability to pay" did not come solely from studies funded by the credit industry. The work of academicians has not been limited to an examination of the actual provisions of bankruptcy reform, but also areas in need of reform that H.R. 975 does not address, such as Professor Lynn LoPucki's extensive studies of forum shopping by large, corporate debtors.

It is also worth noting that groups not normally associated with creditors' rights law have also registered their opposition to bankruptcy reform, including the American Association of University Women, the NAACP, the Voice of Mid-Life and Older Women, and various organized unions.

Supporters, on the other hand, have largely been limited to the banking and credit card interests and other special interest groups that have sought to amend specific sections of the Code for their benefit. Much of this support is extremely well funded and has contributed generously to the political campaigns of members of Congress and the Administration.

Question 2

Much of the debate has been centered [on] whether this bill is pro- or anti-debtor. How would this bill alter the rights of different creditors? Could you identify particular special interest provisions that would grant new, disproportionate rights to particular creditor interests?

Response

As we indicated in our testimony of March 4, 2003, bankruptcy is not simply a two-party dispute with the debtor on one side and creditors on the other. Rather, multiple parties and constituents, often with vastly different interests and goals, play significant roles in the overall process.

When the debate centers on whether bankruptcy reform is "pro-debtor" or "pro-creditor," the need to balance all the varied interests in bankruptcy can easily be overlooked. Of principle concern are the fundamental premises underlying our bankruptcy system: affording creditors fair and equitable treatment, administering the bankruptcy estate as effectively and efficiently as possible, and granting the honest but unfortunate debtor a financial fresh start.

Keeping in mind the need to maintain the delicate balance of these premises, the problems with the proposed bankruptcy legislation in catering to "special interest" groups are easily identified from the following examples from H.R. 975.

> **Sections 404 and 445.** Section 404 grants lessors of commercial real estate virtual veto power in cases involving commercial property leases. Rather than allowing the bankruptcy courts to exercise their discretion regarding the time necessary for a debtor to make decisions to assume or reject leased property, Section 404 ultimately vests that decision with the lessors who will, in all likelihood, use their extraordinary power to exert concessions from the debtor as the *quid pro quo* for the requested extension to the detriment of all other parties in interest. This protection is, of course, in addition to the already preferential treatment that nonresidential real estate lessors currently enjoy under the Code, which requires debtors to timely remit lease payments or risk eviction from the premises.
>
> In addition, Section 445 may fail to appropriately limit the lessor's administrative expense claim in the event a lease is assumed and, thereafter, rejected. This further enhances the lessor's rights, correlatively compounding the harm to all other creditors. Strenuous objection has been raised to this provision and virtually no one, other than the shopping center lobby, supports it.
>
> **Section 306.** Commonly called the "anti-cramdown" provision, Section 306(b) requires that Chapter 13 debtors fully compensate secured creditors pursuant to the terms of the contract if the collateral is a motor vehicle purchased within 910 days before the filing of the petition or within one year pre-petition for other types of personal property security. As originally conceived, this provision was limited to property purchased within 180 days of the petition. With some reservation as to the time period, the CLLA supported the concept of this provision because it would have prevented debtors from purchasing rapidly depreciating property on the eve of bankruptcy.
>
> Congress, however, expanded the applicable time period beyond all acceptable limits and turned what was originally a worthy provision to prevent abusive tactics into a boon for secured consumer financing

lenders, especially those in the auto industry. As currently constructed, Section 306(b) simply diverts Chapter 13 plan value from unsecured creditors to these preferred secured lenders, who are afforded greater rights in bankruptcy than would exist under applicable state law.

Section 223. Even this seemingly well-intentioned provision, which grants priority status to claims arising from personal injury or death caused by the debtor's drunk driving, creates problems. Certainly the claimant in this instance is a sympathetic one, and there are doubtless no "pro-drunk driving" lobbyists knocking on Congressional doors, but this amendment is special interest all the same.

There are only two types of debt that are both nondischargeable and entitled to priority recovery from any estate distribution, tax obligations and support debts. The reason for this preferred treatment is sound public policy and the need to protect the public fisc. Unpaid support debts, for example, create the risk of an increased welfare burden. On balance, Congress determined that a diminished return to the unsecured creditor body justifies avoidance of the risk to support recipients and society as a whole.

This policy consideration is not similarly applicable to debts related to drunk driving. Such debts are already nondischargeable and the claimant can look to the debtor's future income stream for repayment in addition to a pro rata share of any distribution from the estate. Granting priority to these debts simply requires the unsecured creditor body to shoulder a greater portion of the debtor's burden.

Section 212. Section 212 moves support obligations from seventh priority to first, but the Section creates a distinction without a difference. Only in very rare instances do support recipients compete with any of the priority classes ranks second through sixth, as these arise in business bankruptcies. By making this change, however, Congress was able to respond to opponents charging that bankruptcy reform will actually harm support recipients through such provisions as those that expand nondischargeability. Worse, for an extended period of time, Congress even failed to reinstate the expenses of administering the estate as the first priority despite being informed that without compensation trustees were highly unlikely to pursue assets that would ultimately benefit the support recipients.

Section 220. Section 220 expands the exception to discharge for student loans to include loans made by commercial lenders. Under current law, the exception is limited largely to loans made by the government or charitable organizations, a limitation that may be conceptually supported by public policy. As to government loans, the taxpayers would subsidize discharged student loans, while charitable organizations could be rendered unable to provide assistance at all. There is no similar policy to support excepting from discharge student loans made by commercial lending institutions.

Section 445. This section simply prevents the trustee from avoiding warehouseman's liens for storage, transportation, or other costs incidental to the storage and handling of goods. The CLLA can see no discernible difference between this type of statutory lien and others that are fully avoidable under the Code.

Question 3

To what extent would this bill lead to the failure of potentially successful ch. 11 reorganizations? What would be the impact on jobs, trade creditors, and the economy in general?

Response

This question requires a two-part answer because large and small business bankruptcies are differently affected under the bill.

Large Chapter 11 bankruptcies are not radically changed under the bill. There are provisions, however, that will hinder reorganization. For example, Section 404, described above, would permit lessors of commercial real estate to force premature decisions regarding the assumption or rejection of property leases. Large retail businesses or other concerns that have multiple locations often need time to determine which leases they will assume or reject in order to successfully reorganize and emerge from bankruptcy with viable prospects for profitability. Control over the length of time within which debtors must make these decisions should not be ceded to landlords; instead, this decision should remain within the sound and impartial discretion of the court where the interests of all affected parties can be given proper consideration.

Forcing premature decisions regarding real property leases benefits only the lessor. Rejection, of course, leads to the closing of a business location and the consequent loss of jobs. Premature assumption, on the other hand, leads to increased administrative burdens on the estate, making bankruptcy more expensive. In a March 16, 2001, *New York Times* article, Harvey Miller, an attorney involved in the Macy's bankruptcy, for example, stated that recovery by creditors was enhanced precisely because the debtor had the time to make informed decisions about its retail leases.

Premature dismissal or conversion of Chapter 11 cases will also result from Section 442, which requires such action in specified circumstances without regard to whether Chapter 11 reorganization would ultimately prove more beneficial to other parties, including creditors and workers. The court should always retain the discretion to allow the case to proceed toward successful reorganization.

H.R. 975 also fails to address the problem of forum shopping by corporate debtors. The consequences of a corporate bankruptcy are often most profound in the community in which the debtor's principal place of business is located, especially in the relatively smaller cases. Not only are there typically more jobs involved locally, but also the local economy will depend, to a large extent, on business from that debtor. Many critical issues of local importance arise. The debtor may be, for example, one of the community's larger employers, or it may sustain many small businesses that provide various goods and services. The consequences could extend even further, affecting the number of hospital beds that are available, the quality of elder care, or even waste removal. These are but a few of the countless possible issues and each affected community has a vested interest in the outcome of the debtor's case.

Regarding small business, H.R. 975 and its predecessors create an untested procedure for the reorganization of small businesses. The problems begin at the commencement of the bankruptcy case because the definition of "small business," tied to the amount of debt, would include an overwhelming majority of all business bankruptcy cases. Designed with a preference for efficiency over practicality, and justified only by a general belief that some small business cases languish in Chapter 11 despite an inability to recover financially, these provisions mistakenly assume that size is synonymous with complexity. The result will be to eliminate the possibility of otherwise viable reorganization in a great number of cases, causing creditors to go unpaid and workers to lose their jobs. Even supporters of the small business provisions have acknowledged that some debtors will be prematurely liquidated despite viable prospects to emerge as a going concern from bankruptcy.

Note also that forced liquidation of small businesses may cause a further increase in the need for consumer filings. That is, if the proprietor of a small business is not permitted to reorganize, but has guaranteed his firm's debts, he might well need to seek bankruptcy relief himself after his company is liquidated.

Question 4

To what extent should the government expend funds to pursue claims or investigations on behalf of creditors? To what extent should the market place (that is to say, a cost benefit analysis of the cost of collecting the debt versus the value of the debt) decide the manner in which it is pursued?

Response

There is a distinct difference between the pursuit of claims versus investigations undertaken by the government. Regarding the former, the government should never expend funds to pursue claims on behalf of creditors with the exception of the enforcement of legal rights, such as when a state Attorney General acts on behalf of consumer claims. Our legal system operates on the premise that parties must be diligent in the pursuit and vindication of their own rights. Cost/benefit analysis in this regard is irrelevant from the government's perspective, as it is for the specific creditor to determine the value of pursuing any particular claim, whether in bankruptcy or under applicable state law.

The government, however, can and does play a valuable role in ensuring a bankruptcy system that is fair and balanced. A notable example is the National Civil Enforcement Initiative undertaken by the Executive Office of the United States Trustee, which has, as it should, taken significant action in cases involving abuse by both debtors and creditors. As this Initiative proceeds, the data compiled will provide insight as to the types of debtors who engage in abusive conduct, what that abusive conduct is, and other important features such as differences in income and geographic location.

Of equal importance, the Initiative will help illuminate bankruptcy cases in which the debtor has been financially victimized, and consequently in need of bankruptcy relief, by the scams of others. Financially strapped consumers have found their situations made worse through the actions of unscrupulous credit counselors, mortgage scam operators, and bankruptcy petition preparers.

Governmentally funded studies are also important. Section 1308 of H.R. 975 requires a study that will examine how the extension of credit to college students affects the rate of bankruptcy filings, and Section 1229 requires a more general examination on the overall effect of indiscriminate lending practices. A better understanding of consumer credit and debt will enhance the ability of Congress to craft bankruptcy reform legislation that properly addresses areas of genuine abuse, while ensuring access to bankruptcy relief for those truly in need.

The CLLA appreciates this opportunity to provide additional insight on bankruptcy reform. We remain committed to working with Congress to achieve meaningful, balanced and effective bankruptcy reform.

Respectfully submitted,

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Co-Chair, National Governmental Affairs Committee
Chair, Bankruptcy Section
Commercial Law League of America

Jay L. Welford
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PREPARED STATEMENT OF JUDITH GREENSTONE MILLER ON BEHALF OF THE COMMERCIAL LAW LEAGUE OF AMERICA

MARCH 18, 1998

Good morning and thank-you for inviting me to testify as a witness before the House Judiciary Committee's Subcommittee on Administrative and Commercial Law. My name is Judith Greenstone Miller. I am an attorney and a member of the Birmingham, Michigan office of Clark Hill P.L.C., and a member of the Commercial Law League of America, its Bankruptcy and Insolvency Section, and its Creditors' Rights Section. The CLLA, founded in 1895, is the nations oldest organization of attorneys and other experts in credit and finance actively engaged in the field of commercial law, bankruptcy and reorganization, with a membership exceeding 4,600 individuals.

I am honored to address the Subcommittee on H.R. 3150, H.R. 2500 and H.R. 3146, and have been asked to speak about the impact of these consumer proposals on unsecured creditors. The League believes that adoption of many of the consumer proposals contained in H.R. 3150 and H.R. 2500 will enhance the rights of unsecured creditors. Reform is appropriate in circumstances where abuse has been prevalent, such as (i) when debtors incur unsecured debt on the eve of bankruptcy when they are clearly insolvent, in financial distress or in all likelihood unable to pay for the goods or services, or (ii) when debtors obtain advances and such funds are used to extinguish priority or nondischargeable claims.

H.R. 3146 appears to be based on the premise that virtually all of the financial ills faced by consumers today and the increase in bankruptcy filings are caused by credit granters. Credit card issuers in particular cases seem to bear the brunt of the legislation. It is the opinion of the CLLA that H.R. 3146 is unnecessarily punitive and ItS provisions are onerous.

Reasonable people may disagree on some of the specific provisions contained in H.R 3150 and H.R. 2500, however, the CLLA believes that those two bills provide a more balanced and equitable approach to the very real and troubling financial problems being faced by consumers today. While the CLLA generally supports the consumer proposals contained in H.R. 3150 and H.R. 2500, the CLLA wishes to make the following observations and comments:

1. Section 141 of H.R. 3150 and Section 106 of H.R. 2500 grant en unsecured creditor who advances funds used to pay a priority or nondischargeable claim the same attributes as the ultimate recipient of the funds. The CLLA supports this proposal, but at the same time recognizes that it does not contain any time limits, and ultimately the benefit to be derived by the unsecured creditor who has advanced the credit will depend on its ability to trace the funds advanced.
2. Section 142 of H.R. 3150 and Section 107 of H.R 2500 grant nondischargeable status to debts incurred within 90 days of bankruptcy, thereby providing such unsecured creditors with the ability to seek repayment outside the bankruptcy case. While the CLLA recognizes that certain debts incurred on the eve of bankruptcy may be entitled to additional safeguards geared toward repayment, the CLLA believes that the section, as proposed, is overly expansive. It shifts the burden to prove the claim is dischargeable from the creditor to the debtor, which involves the commencement of an adversary proceeding. With such limited funds and resources, debtors are unlikely to be able to rebut the presumption of nondischargeability—thereby impairing the "fresh start" which bankruptcy is intended to provide them. In its written materials, the CLLA has suggested an alternative 2-prong approach, which Congress may wish to consider:

   (i) shorten the time period for the rebuttable presumption from 90 to 30 days, and

   (ii) increase the time period for nondischargeability for purchases of luxury goods from 60 to 90 days.

   This alternative 2-prong test would address the concerns of unsecured creditors by protecting them from nonpayment for goods purchased by debtors on the eve of bankruptcy and provide debtors experiencing financial difficulties disincentives to purchase luxury goods, while at the same time preserving the debtor's "fresh start" and providing fairer treatment to honest debtors, not otherwise abusing the system.
3. The CLLA supports the adoption of Section 143 of H.R. 3150 (which is more expansive than its parallel provision in H.R. 2500) and Section 104 of H.R. 2500, which generally make fraudulent debts incurred in a Chapter 13 bank-

ruptcy proceeding nondischargeable. This represents sound public policy, is consistent with Chapter 7 substantive law, and as a consequence, debtors will no longer be able to discharge such debts by electing Chapter 13 treatment.

4. The CLLA also supports Section 145 of H.R. 3150, which proposes to amend Section 523(a)(2) and make nondischargeable debts incurred by a debtor when there is "no reasonable expectation of repayment." However, as proposed, this amendment is likely to present significant evidentiary problems. Therefore, if Congress seeks to provide unsecured creditors with a tangible and effective remedy under these circumstances, the Subcommittee may wish to consider inclusion of a codified standard setting forth specific factual criteria to prove the debtor's financial state at the time the debt was incurred.
5. The CLLA supports Section 181 of H.R. 3150, which proposes to increase the time period an individual must be domiciled in a state from 180 to 365 days in order to take advantage of a particular state's exemption scheme. Adoption of this provision would impact bankruptcy planning by debtors and negate forum shopping for the purpose of exempting property from the estate. Moreover, in some circumstances, it may result in an increase of the property of the estate to be liquidated by the trustee, thereby increasing the pot of funds available for unsecured creditors.
6. Section 109 of H.R. 2500 proposes that the automatic stay terminate 30 days after the filing of a petition if a prior petition was dismissed under Chapter 7 unless the subsequent petition was filed in "good faith." The CLLA believes that this provision is extreme and will result in impairing the delicate balance contained in the Bankruptcy Code, and further impact the fair treat to be accorded debtors.
7. Section 113 of H.R. 2500 recommends the establishment of a Bankruptcy Exemption Study Commission. While the CLLA does not believe that a study is necessary because the National Bankruptcy Review Commission (the "Commission") extensively reviewed this issue, nevertheless, the CLLA would support such a study. The CLLA also supports the recommendations of the Commission in so far as they foster and promote "uniformity" of exemptions on a national basis to preclude forum shopping. However, the CLLA does not necessarily support the limits contained in the Commission's Final Report.
8. Section 210 of H.R. 2500 expands the debtor's duties upon commencement of a bankruptcy proceeding to file various financial documents (federal tax returns, evidence of payments received, monthly net income projections and anticipated debt or expenditure increases). Debtor's compliance under this provision is required within 10 days of the request by a Chapter 7 or Chapter 13 creditor. The CLLA believes that such enhanced mandatory disclosure will provide additional information for creditors to assess the financial condition of the debtor, a benefit which the CLLA endorses.

The Commercial Law League of America appreciates the invitation to testify on H.R. 3150, H.R. 2500 and H.R. 3146 and their impact on unsecured creditors. I would be happy to respond to any additional inquires or concerns of the Subcommittee contained in my presentation, the written materials or other provisions of these bills. Thank you.

PREPARED STATEMENT OF THE COMMERCIAL LAW LEAGUE OF AMERICA AND ITS BANKRUPTCY AND INSOLVENCY SECTION

MARCH 11, 1999

I. INTRODUCTION

The Commercial Law League of America (the "League"), founded in 1895, is the nation's oldest organization of attorneys and other experts in credit and finance actively engaged in the fields of commercial law, bankruptcy and reorganization. Its membership exceeds 4,600 individuals. The League has long been associated with the representation of creditor interests, while at the same time seeking fair, equitable and efficient administration of bankruptcy cases for all parties involved.

The Bankruptcy and Insolvency Section of the League ("B&I") is made up of approximately 1,600 bankruptcy lawyers and bankruptcy judges from virtually every state in the United States. Its members include practitioners with both small and large practices, who represent divergent interests in bankruptcy cases. The League has testified on numerous occasions before Congress as experts in the bankruptcy and reorganization fields.

The League, its B&I Section and its Legislative Committee have analyzed the "needs based" provisions of H.R. 833, the Bankruptcy Reform Act of 1999 (the "Bill"). The League supports changes to the Bankruptcy Code (the "Code") to limit possible abuses by debtors and credit grantors. Any proposed change will have consequences on the system. It is the goal of the League to help Congress carefully consider the practical implications of each change in order to maintain the delicate balance between the debtors' rights and creditors' remedies and to effectuate fair treatment for all parties involved in the process.

II. ANALYSIS OF SECTION 102—DISMISSAL OR CONVERSION; THE "NEEDS BASED" PROVISION OF THE BILL

This section of the Bill provides the circumstances under which a Chapter 7 proceeding can be dismissed or converted by the Court. Congress has proposed to substantially modify Section 707(b) of the Code as follows:

- Creditor standing to bring motions under Section 707(b) is limited under the proposed legislation. While the League recognizes that the limit is reasonable as drafted, nevertheless, the League believes that the size of the case should not impact creditor standing to bring such motions.
- A case may not be converted to Chapter 13 without the debtor's consent. The League believes that it is appropriate to grant the Court discretion to convert a Chapter 7 proceeding irrespective of the debtor's wishes if the debtor falls within the parameters of the "needs based" provisions, particularly when the debtor has received the benefit of the automatic stay during the interim period. The League recommends that after conversion to Chapter 13, the debtor should be given the right to dismiss the case during a 20-day period from the date of the conversion. The right to dismiss should not be subject to the discretion of the Court.
- "Substantial abuse," as the standard for dismissal has been changed simply to require "abuse." The League believes that the standard should remain "substantial abuse."
- "Abuse" is defined by reference to specific, rigid "needs based" formula, when, in reality, as recognized by Congress, "abuse" may be found to exist based upon a review of the totality of circumstances surrounding the filing. See e.g., subsections 3(A) and (B). No formula, however well considered or crafted, can be flexible enough to encompass the endless combinations of circumstances which debtors bring to the bankruptcy court. While intended to provide a very objective standard, such formulas have proven historically to be the source of much litigation focused at interpreting and defining all of the parameters of the standards. A better approach would be to draft general standards or a more expansive definition of "abuse," which would include, but not be limited to, a finding of "abuse," based on a needs based formula, bad faith or specific behavior or activity. Ultimately, the Court would be required to make a finding after a review of *all* of the facts and the totality of circumstances surrounding the filing of the petition.
- The Bill does not grant the Court any discretion to determine, based on a totality of the facts and circumstances, whether a debtor who has sufficient income under the needs based formula should, nevertheless, be allowed to remain in a Chapter 7 proceeding. The League believes that courts do a good job generally of exercising discretion in individual cases, and therefore, such discretion should continue to be vested in the courts.
- The 5-year period required for calculation and determination of whether a debtor falls within the needs based formula is too long and inconsistent with the 3-year period currently provided in the Code for repayment of obligations under a Chapter 13 plan.
- The standard to rebut the presumption, e.g., "extraordinary circumstances," is rigid, onerous, and likely to result in increased litigation over the evidence necessary to prove compliance with this standard. Moreover, subsection 2(B) requires the "extraordinary circumstances" to be evidenced by an itemized, detailed explanation, proving that such adjustment is both necessary and reasonable, and the accuracy of the information provided in the explanation must be attested under oath by both the debtor and its attorney. This verification requirement by the debtor's attorney is inappropriate, unreasonable and ap-

pears to go beyond the parameters of Federal Rule of Bankruptcy Procedure 9011 and Federal Rule of Civil Procedure 11.

- The needs based formula requires that "current monthly income" be calculated on the basis of all income, from all sources, regardless of whether taxable, received within 180-days from the commencement of the proceeding. The 180-day period may be too short to obtain an accurate review of the debtor's available sources of income, and may also be susceptible to manipulation. The League, therefore, recommends that the assessment period be redrafted to be one year from the date of the commencement of the bankruptcy proceeding.
- Congress has created a new and different standard for the award of fees and costs associated with the bringing of a motion to dismiss or convert under Section 707(b). There is no need to create a new standard, e.g., "substantially justified," when sufficient standards for such relief already exist under Federal Rule of Bankruptcy Procedure 9011 and Federal Rule of Civil Procedure 11. Appropriate sanctions are already available when it can be demonstrated that a creditor has filed a Section 707(b) motion solely for the purpose of coercing the debtor into waiving a right guaranteed under the Code. Moreover, the potential imposition of penalties on the attorney for the debtor if the case is deemed abusive will likely translate into increased costs and fees attendant to preparation and filing of a bankruptcy petition. Lastly, subsection 4(B) exempts a creditor with a claim of less than $1,000 from the imposition of costs and fees. The amount of one's claim should not be a consideration in the award of fees and costs by the Court.

III. THE PROPOSED "NEEDS BASED" CHANGES DO NOT WORK, WILL NOT CURE THE PERCEIVED ABUSES TO THE BANKRUPTCY SYSTEM AND WILL OVERBURDEN AND TAX THE SYSTEM

The National Bankruptcy Review Commission (the "Commission") conducted an exhaustive study and analysis of consumer bankruptcies over the period it was created by Congress. While the Commission recognized the import of a promise to pay, it also acknowledged the need for appropriate relief for those in financial trouble and equitable treatment for creditors within a balanced system. Bankruptcy, in most cases, is the "last stop" for financially troubled individual consumer debtors. The Commission also conceded that there were abuses in the system, but did not ultimately recommend the adoption of a needs based formula or otherwise denying individuals in financial distress access to the courts.

Although bankruptcy filings have increased three-fold during the last 20 years, one cannot conclude that the reason for this increase is solely on account of debtor abuse, unwillingness of individual debtors to honor a promise to repay under a contract and the lack of social stigma associated with bankruptcy—the key factors, on which the needs based formula is erroneously premised. The Commission, bankruptcy organizations, practitioners, academicians and judges have dismissed each of these factors on the basis of the following substantial empirical data:

- The statistical evidence shows that consumers who file for bankruptcy relief today as a group are experiencing financial crises similar to families of 20 years ago.
- Most families who file bankruptcy are seeking relief from debts they have no hope of repaying. In fact, an empirical study commissioned by the American Bankruptcy Institute from Creighton University concluded that the means testing formula would only affect 3% of the Chapter 7 filers because the remaining 97% had too little income to repay even 20% of their unsecured debts over five years. The Purdue Study, funded by the credit card industry, which supported a means based test because it contended that a substantial number of debtors who file could repay their debts, has been criticized as unreliable and misleading by, among others, the Government Accounting Office. This is not the first time that the means testing has been considered—Congress has resisted this attempt over the last thirty years and should decline to endorse this proposal without the demonstration of reliable, cognizable benefits that do not otherwise burden and impair the system.
- The triggering events for filing bankruptcy by individuals depend on individual circumstances, such as layoffs, downsizing, moving from employee to independent contractor status, uninsured medical bills, car accidents, institutionalized gambling, failed businesses, job transfers, caring for elderly parents or children of siblings, divorce, etc.
- At the same time that individual consumer bankruptcies have increased, there has been an increase in available credit and massive marketing cam-

paigns. According to the Consumer Federation of America, from 1992 through 1998, credit card mailings have increased 255%, unused credit lines have increased 250%, while debt has increased only 137%. With increased credit, the littlest financial change in a family can have devastating consequences.

- Kim Kowalewski, Chief, Financial and General Macroeconomic Analysis Unit, Congressional Budget Office, concluded that a study conducted and funded by Visa, USA was "unscientific," "invalid" and "unfounded." The study had suggested that the increase in personal bankruptcies was directly attributable to the decreased social stigma of filing bankruptcy and increased advertising of legal assistance for filing bankruptcy. While the League recognizes that decreased social stigma and increased advertising are contributing factors, that is only the beginning of the analysis and does not constitute the sole bases accountable for the tremendous increase in bankruptcies. Mr. Kowalewski concluded that the increase in bankruptcies was more a function of increased debt rather than a sudden willingness to take advantage of the system. Is it, for example, any less embarrassing for an individual to file a petition in bankruptcy than to have his home foreclosed, his car repossessed or his neighbors contacted by debt collectors?
- Requiring trustees to review each case and apply the means test and forcing debtors into Chapter 13 will overburden the system. Application of the standards and pursuit of a motion is an unreasonable burden for the panel trustees. The trustees are paid only a minimal fee (e.g., $60) for substantial responsibility in no asset cases. The means testing will involve not only analysis in each case, but also numerous motions, many of which are likely to be contested by debtors. If there are no nonexempt assets, which is generally the case in most Chapter 7 cases, how is the trustee to be compensated? Moreover, pursuing a Rule 9011 action against a debtor's attorney is not likely to produce an immediately available and certain source of recovery for the trustee. The trustee could be required ultimately to spend a potentially huge amount of time with little or no assurance of any repayment for such services. This represents a tremendous burden on the system, when according to the National Association of Bankruptcy Trustees, only one in every ten cases subject to the means testing and with apparent ability to propose a Chapter 13 plan are able to actually confirm or complete the plan.
- The establishment of the means test creates a number of anomalies. For example, if a debtor files a Chapter 13 initially, the means formula does not apply, and in a number of jurisdiction, the debtor could propose a zero percent plan and discharge the same debt he would have in a Chapter 7 proceeding. This is not what Congress intended to create under the means test.
- The means test further operates to the exclusion of the trustee's significant avoidance powers. For example, the schedules may reveal a significant preferential payment that, if recovered, would result in a distribution to creditors in excess of what they would receive upon application of the means test. Dismissal of the proceeding under such circumstances is hardly the remedy in the best interest of either the debtor or its creditors.
- The proposed means test invites manipulation by the debtor to fit within the standard. Individuals with secured debt are allowed deductions for such obligations prior to calculating available disposable net income. A debtor with too much income could trade in an old car for a new one, deduct the payment from the means formula and thereby become eligible for Chapter 7 relief. Another option is for debtors with too much income to make use of The Religious Liberty and Charitable Donation Protection Act of 1998, which allows debtors to contribute up to 15% of their gross income to charities. Such contributions are not considered in making the calculation under Section 707(b). A debtor with income of $60,000 could thereby remove $750 per month in disposable income by making the maximum allowable charitable contribution.
- If a debtor does not qualify for Chapter 7 or Chapter 13, the only alternative is Chapter 11—a costly and unfeasible alternative for most individual debtors.
- Judge Edith Holland Jones, in her Dissent to the Final Report of the Commission, has suggested that the sanctity of contract and one's moral obligation to honor promises to repay necessitates establishment of a means test, absent which bankruptcy as a social welfare program will be subsidized by creditors and the vast majority of Americans who struggle and succeed to make ends meet financially. The League is sympathetic to the issues raised by Judge Jones, however, the means test, as proposed, does not remedy the perceived abuse. Determining eligibility merely on the basis of net disposable available

income, without consideration of the myriad of factors contributing to the financial problem and without court discretion, would preclude too many honest first time debtors from obtaining redress from the court of last resort.

- Congress is operating from the premise that filing bankruptcy is per se abusive. Rather, the focus of Congress should be on debtors who abuse the system by serial filings and those provisions of the Code which encourage abuse of the system (e.g., unlimited exemptions). Ultimately, the courts should be given the tools (e.g., the totality of the circumstances, including consideration of a discretionary, flexible means test) and the express authority to determine when abuse is present and how such abuse should be remedied—the concept of a fresh start and maintenance of the delicate balance between debtors' rights and creditors' remedies must be preserved. Under the current Code, the courts do not have the authority to affirmatively look for abuse or fashion an appropriate remedy except in the most egregious circumstances. Adoption of a "totality of circumstances" test, in conjunction with a discretionary means test, would represent a major change and a vehicle by which abuse could be addressed and remedied.

IV. CONCLUSION

Maintaining and enhancing a fair, balanced and effective bankruptcy system requires consideration and debate of all the issues. Any individual change has an impact on the entire system, and cannot and must not be evaluated in a vacuum. The League takes seriously its role in this process, and believes that other options beyond the current mandatory needs based formula should be explored that would address the real abuses and preserve the bankruptcy system which Congress acknowledged it was generally satisfied with in 1994 when this process began and that the system was not in need of radical reform. Adoption of a fixed, rigid needs based formula, as contained in the Bill, represents "radical reform," which has not been justified and will impair the delicate balance inherent in the system; nor is it likely to rid the bankruptcy system of the perceived abuses.

Respectfully submitted,

JAY L. WELFORD, *Co-Chair, Legislative Committee*
JUDITH GREENSTONE MILLER, *Co-Chair, Legislative Committee.*

ARTICLE FROM *THE WASHINGTON POST*
MARCH 04, 2003, TUESDAY, FINAL EDITION

SECTION: A SECTION; Pg. A01

LENGTH: 1159 words

HEADLINE: Called-Up Reservists Take Big Hit in Wallet; Families Struggle on Military Salary

BYLINE: Christian Davenport, Washington Post Staff Writer

BODY:

Spring should be the busy season for the Brinkers' Columbia home improvement business. But instead of cashing in on the jobs that will come up as the weather improves, Lynn Brinker is calling customers to cancel thousands of dollars' worth of work.

It was less than five months ago that her husband, Sgt. Mark Brinker, an Army reservist with the 400th Military Police Battalion, returned from a year-long, post-Sept. 11 deployment to Fort Sam Houston in Texas. To get through that tour, Lynn Brinker cashed in savings bonds meant for the education of their three children, took out a bank loan and borrowed $15,000 from a relative.

Now, Mark has been called up again, this time for the impending war in Iraq, and she doesn't know what they're going to do.

"There is just no way we can make ends meet with him gone again," she said. "It's just ridiculous. We're in our forties, we've worked hard, and we didn't expect to have to be starting all over again like this."

As the Pentagon continues to activate reserve and National Guard troops, some of the biggest sacrifices are being made on the home front. In addition to risking their lives, many soldiers, sailors, airmen and Marines are risking their livelihoods, leaving civilian jobs that pay much better than the military. Families are selling second cars, canceling vacations and postponing paying bills as they steel themselves for drastic reductions in income.

For the reservist on inactive status, the duty can be a welcome source of extra cash. A private with less than two years' experience can pick up $2,849 a year for one weekend a month of drilling and an annual two-week training exercise. A staff sergeant with six years can get $4,628. With a call to active duty, the pay bumps up—$16,282 for a private first class and $26,448 for the staff sergeant, which is tax-free while the military member is in a combat zone.

There are other benefits. Mortgage and credit card rates are reduced. In some cases, the law prohibits landlords from evicting military families even if they haven't paid rent. And employers are required to take reservists back once they return from duty, with no loss in pension benefits or seniority.

But the package comes nowhere near making up for many civilian salaries.

The reservists are volunteers, of course. They have been reminded repeatedly that active duty could come at any time. But many say they signed up for the several thousand a year in extra pay and other perks, not for war.

"I thought I could get some money for school," said Spec. Robert Moore of Pasadena, who spent a year on active duty with the Army's 443rd Military Police Company after the Sept. 11, 2001, terrorist attacks and was shipped off again last week for training at Fort Lee, Va.—most likely a prelude to deployment overseas. "I think most people just thought: 'We're just the reserves. We're not going anywhere.'"

Sgt. Kevin Green hears similar comments from his Army National Guard troops in the 1229th Transportation Company.

"They don't want a weapon in their hands, riding around in another country, worried that they won't come back," he said.

As of last week, 168,083 reserve and National Guard troops were on active duty, including thousands from Washington, Maryland and Virginia. They have guarded al Qaeda and Taliban detainees from Afghanistan at Guantanamo Bay in Cuba and patrolled Iraq's no-fly zone. Now, area troops are getting ready to set up refugee camps in northern Iraq and to transport equipment to the front lines. In the Maryland National Guard, 3,000 of 8,000 members have been called up since Sept. 11, 2001.

"The military can't conduct a war without the National Guard and reserve components," said Maj. Charles Kohler, a spokesman for the Maryland National Guard.

Green's unit probably will be placed somewhere in the Middle East, he said. He doesn't yet know where, but it will be a world away from his civilian life, where he has two children and is in charge of Sears deliveries in Maryland. While on active duty, he expects to lose about $1,000 a month, the equivalent of his monthly mortgage payment.

Green was called up during the Persian Gulf War, and this time around, he thought he knew how to prepare. But still he was caught somewhat off guard.

"You try to put a few dollars away in case of an emergency," he said. "But this isn't an emergency; this is a crisis."

Now, he's praying for two things: "I hope we win the lottery, or at least that our car doesn't break down."

His fiancee, Wanda Jones, will have to work overtime at her pharmaceutical company job to help make up the difference. And they've already had a conversation about finances when he's gone.

"I'm going to cut out shopping at the mall," she said.

Some firms continue to pay troops on active duty, or at least to make up the difference between military and civilian pay. A survey by the Reserve Officers Association of the United States found that of the 154 Fortune 500 corporations that responded to a query, 105 make up the difference in pay. Last year, just 75 of 132 responding companies did so, and in 2001, the number was 53 of 119.

Army Reserve Sgt. Jeffery Brooks, a fraud detection manager from Woodbridge, said his company, Capital One, has agreed to pay him the difference. Otherwise, he would be losing $2,200 a month. "I'd be in real trouble," he said.

Daniel Ray, editor in chief of bankrate.com, an online financial information service that helps reservists, said many people are not so lucky. "Those are generous bosses to have," Ray said. "But if you're self-employed, or you've built up your practice over the years, it can be very hard. When you go away, your practice dries up. Then it doesn't just affect you but your secretary and the people who rely on you."

Not everyone takes a financial hit. Army Reserve Lt. Orlando Amaro would make the same amount guarding a POW camp in Iraq as he does as a D.C. police officer patrolling the streets of Columbia Heights. If he is shipped overseas, where his income wouldn't be taxed, he may come out ahead.

"It won't affect me at all," he said.

Lynn Brinker isn't thinking about coming out ahead. She may sell the Chrysler she and her husband recently bought. She wants desperately to let her 12-year-old son, Chris, continue private viola lessons, and for Kevin, 10, to keep up with the trumpet. She wonders whether she'll be able to afford the registration fees and equipment for youth hockey in the fall.

"My thinking is we'll tap this line of credit and try to keep my kids' lives as normal as possible while their father is away. It's very traumatic for them," she said.

"People may say, 'Well, he signed up for this. You knew this could happen.' But he was away for an entire year, and then leaves four months later. And now we don't know how long he'll be gone. I don't think he signed up for that."

LOAD-DATE: March 04, 2003

March 6, 2003

George Wallace, Esquire
Of Counsel
Eckert Seamans Cherin & Mellot, LLC
1250 24th Street, N.W., Seventh Floor
Washington, DC 20037

Dear Mr. Wallace:

Thank you for appearing before the Subcommittee on Commercial and Administrative Law at the hearing on H.R. 975, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2003," and the need for bankruptcy reform on March 4, 2003. Your testimony, and the efforts you made to present it, are deeply appreciated and will help guide us in whatever action we take on the issue.

Pursuant to the unanimous consent request agreed upon at the hearing, Subcommittee Members were given the opportunity to submit written questions to the witnesses. Questions submitted by the Minority for your written response are annexed. In addition, I request that you respond to the following questions:

> Opponents to H.R. 975 claim that these reforms will allow commercial creditors to compete with women and children owed support for the debtor's limited resources. Accordingly, they claim that this legislation "hurts women and children." How do you respond to this assertion?
>
> Did you receive any compensation in connection with your appearance at the March 4, 2003 hearing before this Subcommittee? If so, please identify the source(s) of that compensation.

Your response to these questions will help inform subsequent legislative action on this important topic. Please submit your written response to these questions by 5:00 p.m. on Wednesday, March 12, 2003, to: Susan Jensen, Subcommittee on Commercial and Administrative Law, B353 Rayburn House Office Building, Washington, DC 20515. Your responses may also be submitted by e-mail to susan.jensen@mail.house.gov. If you have any questions, feel free to contact Ms. Jensen at (202) 225-2825. Thank you for your continued assistance.

Sincerely,

CHRIS CANNON
Chairman
Subcommittee on Commercial and Administrative Law

CC: sj

ONE HUNDRED EIGHTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON THE JUDICIARY

2138 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6216
(202) March 6, 2003
http://www.house.gov/judiciary

Hon. Chris Cannon
Chairman
Subcommittee on Commercial and
Administrative Law
B-353 Cannon House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Attached, please find additional questions submitted pursuant to the unanimous consent request adopted at our hearing on bankruptcy legislation held on Tuesday, March 4, 2003. We believe that these questions are directly relevant to the matter under consideration and reflect members's concerns.

Should you, or any of the witnesses, have any questions concerning this matter, please do not hesitate to contact us.

Thank you for your consideration in this matter and for your willingness to accommodate our concerns. Please also extend once again our gratitude to the witnesses for their cooperation.

Sincerely,

John Conyers, Jr.

John Conyers, Jr.
Ranking Member
Committee on the Judiciary

Melvin L. Watt

Melvin L. Watt
Ranking Member
Subcommittee on Commercial and
Administrative Law

Jerrold Nadler

Jerrold Nadler
Ranking Member
Subcommittee on the Constitution

QUESTIONS FOR GEORGE WALLACE

- In your testimony, you state that the bill's "critics are those with a vested interest in the system staying exactly as it is." Do your clients, whom you describe "a broad coalition of consumer creditors," as well as other proponents of the bill, have a vested interest in changes that will benefit their positions in bankruptcy? Could you provide a list of your members so that the Committee can better assess whether they have any particularized interest in tilting the Code in their favor against the interests of other creditors or the broader public policy goals of the Code? Could you disclose how much each member has contributed to the Coalition and what expenditures the Coalition has made in support of this legislation since 1997?

- You state that bankruptcies impose a cost on all borrowers, yet consumer lending continues to be the most profitable portion of bank lending. The losses are being reported in the areas of fines for illegal conduct, poor business investments and the like. Are profits from consumer lending being used to subsidize these other losses and fines? What guarantee do consumers have that any savings realized from this bill will be passed on to them? The bill does not require it and, quite frankly, although real interest rates are at record lows, none of those savings have been passed on to credit card borrowers.

- According to credit card industry funded studies, used to justify this bill, rates of discharged debt that might otherwise be paid are in the range of 25% according to Dr. Michael Staten's testimony before this Committee in 1999. You dismiss the only non-industry study commissioned by what you call the "pro-consumer American Bankruptcy Institute" which found, using the same data, that only approximately 3%. Do you really believe that ABI, which is composed of bankruptcy professionals from all parts of the profession, including creditor counsel, is really pro-creditor, because that would come as a shock to the creditor attorneys who are members and serve on the board. Are you also aware that Dr. Staten, speaking on a panel on consumer debt sponsored by FDIC last week commented that the bill would have no effect on the number of bankruptcies and that it would at most move 5% of debtors from ch. 7 to ch. 13?

- Your testimony focuses on fraud and misleading statements made by debtors. Are you aware that a debtor can be denied a discharge, have a discharge revoked, and be criminally prosecuted for having done so?

- This bill imposes substantial costs on the government to investigate and audit debtors. Why should the public fisc be used to do the due diligence for major banks and other creditors when they are unwilling to do the investigation themselves or seek more substantial information about the borrower before making an extension of credit? Are you aware that a creditor may examine a debtor at the 341 meeting? Are you aware that a creditor has the right under sec. 343 of the Code and Rule 2004 to conduct an extensive examination, under penalty of perjury, of the debtor's financial circumstance including the production of documents?

– After all the scandals involving conflicts of interest on the part of financial advisors, investment bankers, accountants, and other entities, how do you justify sec. 414, which repeals the requirement that investment bankers must be "disinterested persons" in order to work as professionals in the case? How do you justify sec. 324 which overturns the *Merry-go-round* case by limiting the ability of an aggrieved party to seek redress against accountants who have engaged in some improper conduct in the case?

– Do you believe that the same attorney liability rules should apply to creditor counsel? The bill only provides for the payment of opposing party's costs, even in cases where Rule 9011 has been violated. Also, an entire class of creditors and their attorneys cannot be penalized under this provision even if they are found to have violated Rule 9011, which prohibits, among other things, presenting any document to the court that is "presented for any improper purpose, such as to harass or to cause unnecessary or needless increase in the cost of litigation" as well as the requirements that the legal positions and factual assertions are backed by a reasonable reading of the law and proper evidentiary support. Do you believe that any party in a case should be exempted from any penalty for having done these things?

– Could you provide data on extent to which the members of your organization lend to post-bankruptcy individuals, broken down by chapter 7 and chapter 13.

-- During the period 1994 to the present:

- How much did household debt increase?
- How much did consumer credit outstanding increase?
- How much did the annual number of credit card solicitations increase?

– According to a Bloomberg News report:

Citigroup Inc. said fourth- quarter profit fell 37 percent because of higher loan losses and the cost of settling claims that the world's biggest financial- services company misled customers with biased stock research.

Net income declined $2.43 billion, or 47 cents a share, from $3.88 billion, or 74 cents, in the year-ago quarter, the New York- based company said. Revenue was $18.93 billion, little changed, as fees from credit cards and mortgage lending rose while its Salomon Smith Barney Inc. unit had a loss.

For Chairman and Chief Executive Sanford Weill's bank, businesses aimed at consumers contributed about 98 percent of net income ....

> The company also took a $1.3 billion after-tax charge to set up a reserve to pay for the settlement with regulators and related civil litigation as well as private litigation related to Enron. The reserve was announced last month.
>
> The Salomon Smith Barney securities unit lost $344 million as revenue declined 9 percent to $4.66 billion. Citigroup includes corporate lending in its investment banking results.
>
> Profit from the global consumer business, including credit cards, home lending and fees generated through 459 Citibank branches, rose 26 percent to $2.37 billion.
>
> Credit card earnings rose 30 percent to $939 million, branch profit rose 25 percent and consumer-finance earnings rose 15 percent.

George Stein "CitiGroup Net Falls on Loan Loss Settlement Costs" *Bloomberg News* , January 21, 2003.

Based on this report it appears that consumer borrowers are not subsidizing other consumers who are filing for bankruptcy relief. Rather it appears that consumer borrowers are subsidizing losses due to bad investments and penalties. Please comment.

There is nothing in this bill to guarantee that any savings realized from this bill will be passed on to consumers. The bill does not require it and, quite frankly, although real interest rates are at record lows, none of those savings have been passed on to credit card borrowers. What guarantees do consumers have that any increased returns would be passed on the form of reduced interest rates or other fees? Would the members of your Coalition be willing to accept a provision requiring such a passalong to ensure that the proponents of this bill do not reap a windfall?

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March 11, 2003

Honorable Chris Cannon
Chairman, Subcommittee on Commercial and Administrative Law
Judiciary Committee
United States House of Representatives
2138 Rayburn House Office Building
Washington DC 20515-6216

Dear Chairman Cannon:

I am pleased to answer to the questions presented in your March 6, 2003 letter concerning H.R. 975, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2003", and related issues.

Question: Opponents to H.R. 975 claim that these reforms [contained in the bill] will allow commercial creditors to compete with women and children owed support for the debtor's limited resources. Accordingly, they claim that this legislation "hurts women and children." How do you respond to this assertion?

Response: The bill does not hurt women and children trying to collect child support at all. In fact, it substantially improves the ability to collect child support, as well as protecting the ability of a woman owed a marital property settlement to collect it even when her ex-husband files for bankruptcy. See §§ 211 to 219. These badly needed reforms prevent a debtor who owes child support, alimony or marital property settlement payments from using bankruptcy to delay or defeat payment of those obligations -- something that can be done today.

To be sure, bill opponents have incorrectly claimed that women trying to collect unpaid child support from a bankrupt will have to share anything they can collect with unsecured creditors, particularly credit card companies. That is simply not the case. To try and prove their point, they have to hypothesize situations that can only be described as outlandish -- certainly not likely to happen. Even then, their claims do not hold water.

The bill does slightly modify an existing provision of bankruptcy law which creates a presumption that a debtor whose debts are otherwise discharged should remain liable for a particular debt if that debt arose from purchasing goods and services using a credit card shortly before bankruptcy[1], but only if (1) the debtor bought, in the aggregate, more than $1,150 of "luxury goods or services" -- goods or services not reasonably acquired for the support or maintenance of the debtor or a dependent of the debtor; (2) the purchase occurred within 60 days of filing for bankruptcy; and (3) the debtor acted with fraudulent intent. The bill only makes two changes to this provision. It reduces the $1,150 ceiling on luxuries the debtor can buy to $500 and increases the 60 days to 90. However, what the bill gives it also takes away. Unlike present law which applies the $1,150 ceiling based on all of the debtor's spending within the last 60 days before filing, the bill applies the $500 cap on a single creditor basis. So a debtor with 4 credit cards can in fact buy $1,999 in luxuries using the four cards and avoid the presumption, while under present law he or she would be subject to the presumption.

The provision of existing law which the bill changes is aimed at the practice of "loading up", the practice of someone gaming the system by going out and buying a lot of luxuries, like fancy watches and Hawaiian vacations, on their credit cards just before filing bankruptcy. Bankruptcy usually releases the debtor from credit card debt, and so encourages dishonesty in the days and months leading up to filing. This provision provides a corrective, and the bill is intended to make the corrective more effective.

Once these minor changes to improve bankruptcy controls on abusive conduct are understood, it is difficult to believe that they will affect very many cases, or have a significant impact on anyone other than debtors. In any event, the changes clearly don't affect child support collection. To be sure, grasping for an explanation, opponents hypothesize an ex-husband who emerges from bankruptcy owing both child support and fraudulently incurred credit card debt. When it is pointed out that the same situation can happen today under present law, bill opponents then claim that somehow women and children trying to collect the unpaid child support from the bankrupt parent will have to compete with the credit card company for payment, and that the credit card company will win since it has vast resources at its disposal. The answer to that claim is simple. In this country, our legal system requires that child support virtually always be paid first. For example, as mandated by federal law, the state operated child support collection system provides virtually free collection for unpaid support, has nationwide search capability to find the parent who had not paid, and collects the unpaid support from wages as earned, in just the same way as taxes are withheld. The debtor never gets the money. The credit card company can only collect money the debtor has.

The simple fact is that child support creditors virtually always win over credit card collection efforts. That doesn't mean that child support is always collected. Debtors

[1] A parallel provision applies to cash advances on a credit card.

can be disabled and unable to earn, or they can run off, earn money only in the cash labor market, or otherwise defeat payment. But that will thwart anyone trying to collect from that debtor -- whether child support creditor or credit card collector. In other words, if there is money, the child support creditor gets it first. Opponents in their zeal to claim that somehow this bill hurts women and children dreamed up a problem that doesn't really exist.

Question: Did you receive any compensation in connection with your appearance at the March 4, 2003 hearing before this Subcommittee? If so, please identify the source(s) of that compensation.

Response: I did not receive any compensation in connection with my appearance, nor in preparing these responses. I have retired from my law firm, and significantly reduced my work schedule. I agreed to return to testify in favor of the consumer provisions of the bill because I strongly support the objectives behind the reform effort, and am familiar with the substantive and procedural structure of consumer bankruptcy, the policies that underlie the reform effort, and the provisions of the bill.

Minority Questions:

Question: In your testimony, you state that the bill's "critics are those with a vested interest in the system staying exactly as it is." Do your clients, whom you describe [sic] "a broad coalition of consumer creditors," as well as other proponents of the bill, have a vested interest in changes that will benefit their positions in bankruptcy? Could you provide a list of your members so that the Committee can better assess whether they have any particularized interest in tilting the Code in their favor against the interests of other creditors or the broader public policy goals of the Code? Could you disclose how much each member has contributed to the Coalition and what expenditures the Coalition has made in support of this legislation since 1997?

Response: First, I do not have an attorney-client relationship with the Coalition, as explained above. I testified in favor of the consumer provisions of the bill because I believe that the bankruptcy system has grown to tolerate and even encourage fraudulent, dishonest and irresponsible behavior day after day, and that the bankruptcy system must be reformed if it is to carry out its legitimate and beneficial purposes. The simple fact is that those who most vehemently oppose the bill are those with the greatest vested interest in keeping the system exactly as it is no matter how bad.

The Coalition for Responsible Bankruptcy Laws has a vested interest in seeing the intent of the bankruptcy code -- to provide a safety net for the honest debtor -- restored. Its members are concerned that if the present system continues to tolerate and encourage fraud, dishonesty and irresponsibility, the underpinnings of the consumer credit system will be seriously damaged. Widely available, convenient and low-cost credit for Americans is built upon willing repayment by most borrowers. The present bankruptcy system has allowed far too much abuse by those seeking to game the system, and it rewards irresponsible behavior by those with significant ability to repay. The Coalition has a strong interested in ending the patterns and practices which unnecessarily raise the cost of credit and harm the average bill-paying consumer.

As to the membership of the Coalition, I attach a letter sent to Members of Congress last year which lists whom I understand are the current members. As to contributions to the Coalition, I understand that the Coalition is not an incorporated entity, but instead a confederation of those interested in consumer bankruptcy reform. Prior to 2001, I am told that no money was paid to the Coalition or on its behalf, and it, in turn made no expenditures. Beginning in 2001, the Coalition filed lobbying reports reporting its expenditures. These are public record documents. The amount of expenditures reported for 2001 is $380,000 and in 2002 it was $220,000. I also understand that the Coalition spent all money it received on the expenses covered in those reports.

Question: You state that bankruptcies impose a cost on all borrowers, yet consumer lending continues to be the most profitable portion of bank lending. The losses are being reported in the areas of fines for illegal conduct, poor business investments and the like. Are profits from consumer lending being used to subsidize these other losses and fines? What guarantee do consumers have that any savings realized from this bill will be passed on to them? The bill does not require it and, quite frankly, although real interest rates are at record lows, none of those savings have been passed on to credit card borrowers.

Response: To my knowledge, consumer lending revenue is not subsidizing other losses and fines. In a large company with many different business divisions, one year a division may make money when another does not. In the next year, it is not uncommon for a formerly profitable division to not do particularly well, while another does do well. That is common, and it is not considered subsidization.

Generally, I am not aware of any evidence that over a period of years, U.S. consumer banking has been more profitable than commercial banking. At this moment, it may well be that the unprecedented size and number of large corporate bankruptcies has temporarily rendered commercial lending to be unprofitable for some institutions and less profitable for many. However, I am by no means certain that consumer lending is the only profitable part of banking right now. Many bankers would tell you that small business lending is quite profitable. I think that once we get beyond the current troubles of the airline and telecom sectors, commercial lending profitability should be fine. It is important not to confuse short term outcomes with long term trends.

As for a guarantee to consumers that reforming bankruptcy and removing dishonesty, fraud and irresponsiblity from the system will result in lower credit prices, simple economics provides the answer that reform will have that effect. If abuse of the bankruptcy system is reduced, the costs of providing credit-related products and services to consumers will decrease. As operating costs decrease, competition in the consumer lending marketplace will reduce prices for consumers. This will happen in just the same way that lower cost of funds over the last few years has driven down consumer credit card interest rates. According to the Federal Reserve Board, the interest rate on credit card accounts in November 1994 (the first month the statistics were provided) was 15.77% for credit card accounts which were actually assessed interest. By 1999, the Federal Reserve Board reports they had dropped to 15.21%. In 2001, when prevailing interest rates fell again, the average card rate fell to 14.89%. In November 2002, the interest rate was 12.78% on the same accounts, a reduction of approximately 20% overall. This information can be found at www.federalreserve.gov/releases/g19/hist/cc_hist_tc.txt and at Federal Reserve Bulletin, February 2003 issue, page A34, Table 1.56 "Terms of Consumer Credit." Of course, the price of unsecured lending is based on more than the cost of funds. For example, operating losses, such as those incurred through abuse of the bankruptcy system, affect the cost of unsecured credit.

To look at this in another way, the attached information which shows net chargeoff rates on loans by type of loan, summarized from the September 30, 2002, quarterly financial regulatory reports filed with the Federal Reserve Board by all bank holding companies, shows that the annualized net chargeoff rate for credit cards was 5.26%, or 44 times the rate on first-lien home loans, 28 times the rate on home equity lines of credit and 2.8 times the rate on auto/personal (a category that is mostly auto loans, which are secured by the vehicle, plus some unsecured personal loans).

Obviously, the more a loan has collateral behind it, the lower the chargeoff rate is. Why? When loans have collateral, you are much more likely to be paid even in bankruptcy.

The interest rate today on a first-lien 30-year fixed-rate mortgage is about 5.8%. The interest rate on a home equity line of credit is typically the prime rate, which is 4.25% as of this writing. The average interest rate on a credit card according to the Federal Reserve Board is now 12.78%, or two to three times the rate on mortgage and home equity loans. As mentioned above, these rates have been falling as the cost of funds decreases. The reason that credit card rates have not fallen even further is that the card issuers' loan loss rates have increased. This has offset much of the banks' savings from the lower cost of funds.

Banks provide mortgages and they provide credit cards, but the latter is always priced higher than the former. Since the *cost of funds* to finance mortgages and credit cards is nearly identical, the difference in cost to banks is the *loss rate*. When loss rates are low, interest rates are reduced. Since banks do compete vigorously in credit cards and in other loan forms, the interest rate on credit cards and other unsecured loans is going to fall if and when the loss rates fall. So, to the extent that more realistic bankruptcy rules would reduce either the number of filings or the losses resulting in filings, then consumers' credit card interest rates will decline.

Question: According to credit card industry studies, used to justify this bill, rates of discharged debt that might otherwise be paid are in the range of 25% according to Dr. Michael Staten's testimony before this Committee in 1999. You dismiss the only non-industry study commissioned by what you call the "pro-consumer American Bankruptcy

Institute" which found, using the same data, that only approximately 3% [sic]. Do you really believe that ABI, which is composed of bankruptcy professionals from all parts of the profession, including creditor counsel, is really pro-creditor, because that would come as a shock to the creditor attorneys who are members and serve on the board. Are you also aware that Dr. Staten, speaking on a panel on consumer debt sponsored by FDIC last week commented that the bill would have no effect on the number of bankruptcies and that it would at most move 5% of debtors from ch. 7 to ch. 13?

Response: I am aware of Dr. Staten's recent comments. The confusion may stem from the fact that the comparison made above is not "apples to apples," but rather "apples to oranges."

Dr. Staten's 1999 study was based on a random sample of consumer bankruptcy cases in several selected major markets across the country and was conducted before any bankruptcy reform legislation was introduced. It asked only how many consumers had ability to repay their unsecured debts, and concluded that 25% of the cases showed ability to repay. It is quite likely that this finding accurately reflects the degree of ability to pay which exists today, although the means test in H.R. 975 and its predecessors deal with only a portion of this group.

No one who has looked at the issue seriously denies that there are a significant number of debtors each year who use chapter 7 bankruptcy and have ability to repay a significant portion of their debts, or would be shifted out of chapter 7 were H.R. 975 enacted. There is disagreement at the margin over how large the group of debtors directly affected by reform would be, complicated by the fact that over the years Congress has amended the original proposal and added a number of restrictions on the means test which reduce its effectiveness. A study using a national random sample of bankruptcy cases conducted by Ernst & Young found that under the then provisions of the bankruptcy bill, approximately 7-8% of debtors nationally would be required to shift out of chapter 7, had reform been enacted in that form. Using a different sample from only 5 or so bankruptcy courts, the ABI study concluded that only 3% would be required to shift out of chapter 7. The ABI study, however, assumed that debtor allowed expenses would be significantly larger than Ernst & Young did. The Ernst & Young study more accurately reflected how debtor expenses would be calculated were reform enacted.[2] In addition, the two studies used different samples. The Ernst & Young sample was national; the ABI study was localized. Other local studies, including one done by a Bankruptcy judge, have concluded that there are a significant number of debtors now using chapter 7 who have significant ability to repay. Dr. Staten's finding that 5% of debtors would be shifted out of chapter 7 by a means test like that in H.R. 975 lies midway between the ABI study and Ernst & Young's findings.

[2] For example, the ABI study assumed that if a debtor had car payments with two years to run when the debtor filed bankruptcy, the court would allow expenses for the debtor that included the car payment for all five years. I believe that the ABI approach significantly overstates what expenses a court applying H.R. 975 would allow.

In any event, the number of debtors using the system who have ability to repay is certainly significant no matter which study you choose to believe. In 2002, there were approximately 1.1 million consumer chapter 7 bankruptcy filings. If only 3% of those would be shifted out of chapter 7, that is still 33,000 cases. At 5% it would be 55,000 cases. At 7% it would be 77,000 cases. We are still talking about billions in cost savings. The bankruptcy system can ill afford to allow that many debtors with ability to repay to slip through the system each year. Doing so encourages irresponsibility, at the least, if not much worse consequences.

Perhaps most important, as Dr. Staten has pointed out to me, the overall impact of bankruptcy reform like H.R. 975 will come from the sum of all its provisions, including the means test. The whole is greater than its parts. By bringing honesty back into the bankruptcy system, the system will provide relief to the honest, responsible debtor while appropriately identifying and dealing with the debtor who is not honest or responsible. The means test is an important contributor because it reduces the number of debtors who irresponsibly use the system when they can repay a significant part of their debts. But many other provisions of the proposed reform address other features of the bankruptcy system badly in need of reform. For example, the auditing requirement in conjunction with administrative reforms will have a significant impact, as will pre-filing debtor counseling and post-filing debtor education.

Question: Your testimony focuses on fraud and misleading statements made by debtors. Are you aware that a debtor can be denied a discharge, have a discharge revoked, and be criminally prosecuted for having done so?

Response: Yes, but these provisions have been ineffective. There also are penalties for jaywalking in New York City, but everyone knows this law is not enforced; therefore, jaywalking is common. Debtors who make fraudulent and misleading statements under oath on their bankruptcy schedules are rarely caught and punished by the present bankruptcy system. That is why the bill requires random audits of the information debtors provide when they file for bankruptcy and institutes a special section to detect and prosecute fraud. The present system relieves debtors of their obligations to repay, but fails to uncover in too many cases hidden assets, undisclosed income and padded expenses.

Question: This bill imposes substantial costs on the government to investigate and audit debtors. Why should the public fisc be used to do the due diligence for major banks and other creditors when they are unwilling to do the investigation themselves or seek more substantial information about the borrower before making an extension of credit? Are you aware that a creditor may examine a debtor at the 341 meeting? Are you aware that a creditor has the right under sec. 343 of the Code and Rule 2004 to conduct an extensive examination, under penalty of perjury, of the debtor's financial circumstance [sic] including the production of documents?

Response: We could replace public police departments with for-profit private forces, too. But that would involve an abdication by government of its responsibilities.

Bankruptcy is a federal program designed to provide an *honest* debtor who discloses *accurately* his or her assets, liabilities, income and expenses with a program that discharges unsecured debt, on condition that the debtor give up to creditors assets which are over permitted exemptions. It is not supposed to provide these benefits to debtors who lie about or conceal assets, income or expenses, and so game the system.

Since bankruptcy is a public program, it is the obligation of government to assure that the program is honest and run the way it is supposed to. It is government's obligation to enforce the criteria it establishes for relief, and insist on honesty instead of tolerating significant fraud and abuse. Accomplishing that goal requires accurate information about the debtor's assets and finances which only the debtor has at the time of the debtor files for bankruptcy, and making sure that information is reliable should be a government expense. The public cannot afford to base bankruptcy relief on unreliable information. In fact, the lack of reliable information on the use of the bankruptcy system is an embarrassment.

As for the reference to Sections 341 and 343 and Rule 2004, I am aware of what the law and rules state. As practical matter, the current bankruptcy system is so overwhelmed by fraud, dishonesty and irresponsibility that the effective operation of these provisions is frustrated.

Question: After all the scandals involving conflicts of interest on the part of financial advisors, investment bankers, accountants, and other entities, how do you justify sec. 414, which repeals the requirement that investment bankers must be "disinterested persons" in order to work as professionals in the case? How do you justify sec. 324 which overturns the *Merry-go-round* case by limiting the ability of an aggrieved party to seek redress against accountants who have engaged in some improper conduct in the case.

Response: I understand that the Coalition focuses solely on consumer bankruptcy issues, although individual members take positions on commercial issues.[3] It has taken no position on this issue.

Question: Do you believe that the same attorney liability rules should apply to creditor counsel? The bill only provides for the payment of opposing party's costs, even in cases where Rule 9011 has been violated. Also, an entire class of creditors and their attorneys cannot be penalized under this provision even if they are found to have violated Rule 9011, which prohibits, among other things, presenting any document to the court that is "presented for any improper purpose, such as to harass or to cause unnecessary or needless increase in the cost of litigation" as well as the requirements that the legal positions and factual assertions are backed by a reasonable reading of the law and proper evidentiary support. Do you believe that any party in a case should be exempted from any penalty for having done these things?

[3] The vast majority of Coalition members also support the financial netting provisions in the bill.

Response: I have reviewed the provision I believe you are referring to and do not understand the basis for your question. The provisions applying to liability of debtor's counsel for violating Rule 9011 and a creditor for violating rule 9011 appear to be essentially parallel. Moreover, nothing in what I have read in the bill limits the scope of current Rule 9011, which stands on its own and provides an independent basis for controlling party misconduct.

Question: Could you provide data on extent [sic] to which the members of your organization lend to post-bankruptcy individuals, broken down by chapter 7 and chapter 13.

Response: I do not have this information, and I understand that the Coalition does not have this information.

Question: During the period 1994 to the present:

- How much did household debt increase?
- How much did consumer credit outstanding increase?
- How much did the annual number of credit card solicitations increase?

Response: To the extent that these numbers are available anywhere, they are all published in the monthly Federal Reserve Bulletin, which in separate tables estimates total mortgage debt on 1-4 unit (residential) homes and non-real-estate consumer credit. For an average debt load per household, you could divide these numbers by the number of households in each year, as published by the Census Bureau on their web site. However, see my discussion below as to whether the result would be a reliable indication of debt load. I don't think it would be.

To the extent I have been able to find figures for you, I can provide this information. In 1992, household debt as a percentage of total assets was 14.5%. In 1995, it was 14.6%. In 2001, it had fallen to 12.1%. This information can be found in the January 2003 Federal Reserve Bulletin, "Recent Changes in U.S. Family Finances: Evidence from 1998 and 2001 Survey of Consumer Finances." The total amount of nonmortgage consumer credit outstanding in 1994 was approximately $1 trillion according to the Federal Reserve Board. In January 2003, the amount was approximately $1.7 trillion according to the Federal Reserve Board. According to the Federal Reserve Board, nonmortgage consumer debt has grown at approximately the same pace as disposable personal income over the past generation. This information can be found in the September 2000 Federal Reserve Bulletin, "Credit Cards: Use and Consumer Attitudes, 1970-2000." It is also important to note that some of this credit is in the form of "convenience credit" on credit cards—amounts that will be paid in full upon receipt of the monthly payment. As for the number of credit card solicitations made, I do not have this information.

These statistics require considerable qualification when considered in the context of bankruptcy. The fact is that no one actually knows how much consumer debt exists in total -- this year or any year. In fact, there is no common agreement on how to define what "debt" is, as opposed to spending, for these purposes.

For instance, when the Federal Reserve Board adds up credit card "debt," it includes all amounts owed on cards at a moment in time, even if those balances are going to be paid in full at the end of a month and therefore are free of interest. Is this debt, or is it spending?

Also, while the Federal Reserve Board does estimate mortgage debt owed by home owners, it does not tally the housing burden paid or owed by renters. It considers a monthly mortgage amount to be debt, but a monthly rent payment to be spending, not debt. Even if you rent an apartment under a 5-year lease, (which, if you were a corporation, you would have to capitalize in accounting as debt), the Federal Reserve Board ignores this in counting "debt." If you converted renters' monthly payment burdens into a pro-forma "debt" amount, it would surely exceed $1 trillion.

As for rent payments that are past due, no one has been able to approximate this information, and it is not included when debt load is calculated using the figures given above.

Neither the Federal Reserve Board nor anyone else even tries to tally some of the types of debt that frequently lead to bankruptcy, such as medical debt, child support debt, and alimony debt. I am aware of no reliable statistics on phone, electric, and other utility debts owed or past due, either.

In other words, trying to use these statistics to try to draw conclusions about the relation of bankruptcy use to debt load or credit use will not produce reliable results because the underlying data is not accurate.

The question implies that the only reason bankruptcies are increasing is because debt is higher, and bank credit card marketing is to blame for higher debt. But credit card debt is a very small part of total consumer debt, and it is the total amount each consumer owes which drives him or her into bankruptcy. By far the biggest increase in the dollars of consumer debt that we know about is in home mortgages, and the reason is not aggressive bank marketing of mortgage loans, but rather the increase in home prices since 1996.

Question: According to a Bloomberg News report:

"Citigroup Inc. said fourth-quarter profit fell 37 percent because of higher loan losses and the cost of settling claims that the world's biggest financial-services company misled customers with biased stock research.

"Net income declined $2.43 billion, or 47 cents a share, from $3.88 billion, or 74 cents, in the year-ago quarter, the New York-based company said. Revenue was $18.93 billion, little changed, as fees from credit cards and mortgage lending rose while its Salomon Smith Barney Inc. uni5t had a loss.

"For Chairman and Chief Executive Sanford Weill's bank, businesses aimed at consumer contributed about 98 percent of net income....

"The company also took a $1.3 billion after-tax charge to set up a reserve to pay for the settlement with regulators and related civil litigation as well as private litigation related to Enron. The reserve was announced last month." [sic]

Response: I am not familiar with Citigroup's financial statements. However, it is undeniable that consumers who pay their debts pay higher credit prices because of those who do not repay. As I noted above, when credit card company costs decrease, consumers have in fact seen the benefits in the form of lower interest rates. In the last few years, lowered cost of funds (interest rates) have resulted in record low credit card interest rates. Just as lower costs of funds have benefited consumers by resulting in lower consumer interest rates, so would lower operating costs associated with abuse of the bankruptcy system. Therefore, reducing bankruptcy abuse is clearly in the interest of consumers.

Thank you for the opportunity to respond to these questions.

Sincerely yours,

George J. Wallace

Enclosures: (letter from Coalition dated September 4, 2002 [electronic copy]; statistical analysis from SMR Research Corp.)

Coalition for
Responsible
Bankruptcy Laws

September 4, 2002

The Honorable J. Dennis Hastert
Speaker of the House
United States House of Representatives
The Capitol, H-232
Washington, D.C. 20515

Dear Speaker Hastert:

For the last six years the undersigned associations and their members have been involved in the effort to update our nation's bankruptcy laws. We have seen first hand the dramatic effect that the misuse of bankruptcy has had on both consumers' finances and on our ability to serve the public. In 1980, during a very difficult economic period, 300,000 bankruptcy petitions were filed. In comparison, during five of the past six years, in times of record economic expansion, there have been more than one million filings each year. This year, over 700,000 non-business filings were reported in the first two quarters alone. If current practices continue, approximately 1 out of every 7 U.S. households will have filed for bankruptcy within this decade.

Consumer spending and consumer credit are vital to preventing further deterioration in the economy. Allowing a comparatively small number of consumers to abuse the system and discharge a large amount of debt when they have the ability to repay impairs credit availability and raises costs to other consumers at a critical time for the economy. Bankruptcy should not be a mere convenience or financial planning tool for the rich, but should rather be a safety net for those who genuinely need it.

Bankruptcy legislation has been debated and refined, revised and amended repeatedly over the past several years. Indeed, bipartisan majorities of the House and the Senate have voted again and again in favor of this legislation, often with veto-proof margins. While no one can agree with every word on every page, taken as a whole it is a

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Coalition for
Responsible
Bankruptcy Laws

balanced and compelling legislative achievement. It will do much to educate consumers, protect those who rely on alimony and child support, help prevent corporate criminals from hiding their assets and arrest the general misuse of our nation's bankruptcy laws.

We urge you to pass the long overdue conference report for H.R. 333 before Congress adjourns.

Advanta Corporation
Alabama Retail Association
America's Community Bankers
American Bankers Association
American Financial Services Association
American Furniture Manufacturers Association
American Land Title Association
Arizona Retailers Association
Arkansas Grocers and Retail Merchants Association
Associated Oregon Industries Retail Council
Badcock Home Furnishing Centers
Bank of America
Belk, Inc.
Berlin's
Boscov's Department Stores, LLC
Brown Furniture Co.
California Retailers Association
Chamber of Commerce of the United States
Charming Shopps, Inc.
Citigroup
Colorado Retail Council
Commercial Home Furnishings
Connecticut Retail Merchants Association
Consumer Bankers Association

Continental Credit Corporation
Daimler Chrysler Services North America LLC
Dearden's
Deere & Company
Delaware Retail Council
Dillards
El Dorado Furniture
Fannie Mae
Federated Department Stores, Inc.
Financial Services Forum
Financial Services Roundtable
Florida Retail Federation
Ford Motor Company
Garden City Furniture
Georgia Retail Association
Giff Home Furnishings
Household International
Idaho Retailers Association, Inc.
Illinois Retail Merchants Association
Independent Community Bankers of America
Indiana Retail Council
International Council of Shopping Centers
International Music Products Association
Iowa Retail Federation
J. P. Morgan Chase
Jordon's Furniture
Kentucky Retail Federation
Kerby's Furniture
Klingmans Furniture Company
Lack's Furniture Stores, Inc.
Louisiana Retailers Association
Maine Merchants Association
Maryland Retailers Association
MasterCard International Incorporated
MBNA America Bank
Metris Companies, Inc.
Michigan Retailers Association
Minnesota Retailers Association
Missouri Retailers Association
Montana Retail Association
Morgan Stanley
Mortgage Bankers Association of America
National Apartment Association
National Home Furnishings Association
National Multi Housing Council
Nebraska Retail Federation

New Jersey Retail Merchants Association
New Mexico Retail Association
Norman Stockton, Inc.
North American Dealers Association
North Carolina Retail Merchants Association
North Dakota Retail Association
Ohio Council of Retail Merchants
Pennsylvania Retailers' Association
Pier 1 Imports
Retail Association of Mississippi
Retail Association of Nevada
Retail Council of New York State
Retail Merchants of Hawaii
Retail Merchants of New Hampshire
Retailers Association of Massachusetts
Rhode Island Retail Federation
Rush Wilson Ltd.
Saks Incorporated
Schewel Furniture Company
Sears Roebuck & Company
South Carolina Retail Merchants Association
South Dakota Retail Association
Standard Furniture Company
Target Corporation
Tennessee Council of Retail Merchants
Texas Retailers Association
The Bon-Ton Stores, Inc.
The May Department Stores Company
The Neiman Marcus Group, Inc.
The Room Store
Utah Retail Merchants Association
Vermont Retail Association
Virginia Retail Merchants Association
Wachovia Corporation
Washington Retail Association
Wells Home Furnishings
West Virginia Retailers Association
Western Home Furnishings Association
Wisconsin Merchants Federation
Wyoming Retail Merchants Association

BAD LOANS AT BANK HOLDING COMPANIES, September, 2002
Summed data for all top-tier bank holding companies from their September, 2002, quarterly reports to the Federal Reserve.

Source: SMR Research Corp.

Number of bank holding companies summed: 1,946

	PORTFOLIO	% 90+ DEL.	% CHGD OFF	% RE-COVERED	% NET CHGD OFF
CREDIT CARDS1	384,349,628	1.91	5.80	.54	5.26
AUTO/PERSONAL LOANS1	463,471,523	1.10	2.32	.47	1.85
HELOC1	233,415,195	.37	.22	.03	.19
OWNED CLOSED-END JR LIENS	110,186,324	.97	.58	.07	.51
1ST LIEN HOME LOANS2	1,680,573,514	1.44	.14	.02	.12
CONSTRUCTION/LAND LOANS	191,570,545	1.09	.19	.03	.16
FARM R.E. LOANS	31,581,675	1.78	.13	.03	.10
MULTI-FAMILY LOANS	72,029,556	.36	.07	.02	.05
COMMERCIAL R.E. LOANS	509,055,524	.90	.17	.04	.13

1 INCLUDES SECURITIZED AMOUNTS
2 1ST LIEN HOME LOANS INCLUDES SECURITIZED 1ST LIENS, PLUS SECURITIZED JR LIEN HOME LOANS
Note: Chargeoff, recovery, and net chargeoff percentages are annualized, meaning the first three quarters of the year were reset to reflect a full-year outcome assuming continuation of the existing trend-line.