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THE BANKRUPTCY REFORM ACT OF 2001

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

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CONTENTS

STATEMENTS OF COMMITTEE MEMBERS

	Page
Durbin, Hon. Richard J., a U.S. Senator from the State of Illinois	123
Grassley, Hon. Charles E., a U.S. Senator from the State of Iowa	120
Hatch, Hon. Orrin, a U.S. Senator from the State of Utah	2
Kennedy, Hon. Edward M., a U.S. Senator from the State of Massachusetts	121
Leahy, Hon. Patrick J., a U.S. Senator from the State of Vermont	4
Schumer, Hon. Charles E., a U.S. Senator from the State of New York	109
Specter, Hon. Arlen, a U.S. Senator from the State of Pennsylvania	1
Thurmond, Hon. Strom, a U.S. Senator from the State of South Carolina	129

WITNESSES

Becker, Hon. Edward R., Chief Judge, United States Court of Appeals for the Third Circuit, Philadelphia, PA	9
Beine, Kenneth H., President, Shoreline Credit Union, Two Rivers, WI	49
Manning, Robert D., Senior Research Fellow, Institute for Higher Education, Law, and Governance, University of Houston Law Center, Houston, TX	57
Newsome, Hon. Randall J., Judge, United States Bankruptcy Court, Northern District of California, Oakland, CA	19
Sheaffer, Dean, Vice President, Director of Credit, Boscov's Department Stores, Inc., Laureldale, PA	76
Strauss, Philip L., Principal Attorney, San Francisco Department of Child Support Services, San Francisco, CA	37
Vullo, Maria T., Partner, Paul, Weiss, Rifkind, Wharton and Garrison, New York, NY	81
Williamson, Brady C., Attorney, LaFollett, Godfry and Kahn, and former Chair, National Bankruptcy Review Commission, Madison, WI	43
Zywicki, Todd J., Assistant Professor of Law, George Mason University School of Law, Arlington, VA	87

QUESTIONS AND ANSWERS

Responses of Philip L. Strauss to Questions from Senator Biden	130
Responses of K.H. Beine to Questions submitted by Senator Feingold	132
Responses of Randall J. Newsome to Questions submitted by Senator Feingold	134
Responses of Philip L. Strauss to Questions submitted by Senator Feingold	135
Responses of Todd I. Zywicki to Questions submitted by Senator Feingold	137
Responses of Dean Sheaffer to Questions submitted by Senator Feingold	138
Responses of Brady C. Williamson to Written Questions	139
Responses of the Administrative Office of the Courts to Questions submitted by Senator Leahy	140
Responses of Robert D. Manning to Questions submitted by Senator Leahy	142
Responses of Todd Zywicki to Questions submitted by Senator Leahy	147

SUBMISSIONS FOR THE RECORD

American Bar Association, Governmental Affairs Office, Washington, DC, statement	150
Arnold, Hon. Richard S., U.S. Circuit Judge for the Eighth Circuit, statement	152
Association of Financial Guaranty Insurors, statement	153
Block-Lieb, Susan, Professor of Law, Fordham University, New York, NY, statement	155
Bond Market Association, Washington, DC, statement	157

	Page
Commercial Law League of America, Chicago, IL, statement and attachment .	163
Consumer Mortgage Coalition, statement	166
International Council of Shopping Centers, Alexandria, VA, statement	169
Jones, Hon. Edith H., United States Court of Appeals, Fifth Circuit, Houston, TX, statement	173
United States Department of Justice, Office of Legislative Affairs, Jon P. Jennings, Acting Assistant Attorney General, statement	175
Wallace, George J., Eckert Seamans Cherlin & Mellott LLC, Washington, DC, statement	176

THE BANKRUPTCY REFORM ACT OF 2001

THURSDAY, FEBRUARY 8, 2001

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 10:10 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Orrin G. Hatch, Chairman of the Committee, presiding.

Present: Senators Hatch, Grassley, Specter, Kyl, Sessions, Leahy, Kennedy, Biden, Feinstein, Feingold, and Schumer.

Chairman HATCH. We are happy to welcome you all out to the committee this morning. I will give my remarks immediately after Senator Specter, who wants to introduce Judge Becker from the Third Circuit Court of Appeals, and then we will move on from there with the Ranking Member and then to Judge Becker.

STATEMENT OF HON. ARLEN SPECTER, A U.S. SENATOR FROM THE STATE OF PENNSYLVANIA

Senator SPECTER. Thank you very much, Mr. Chairman, for your courtesy in permitting me to start. I have another commitment which I have to attend to.

It is a great pleasure for me to present Chief Judge Edward Roy Becker from the Court of Appeals for the Third Circuit to this committee. I haven't known Judge Becker very long, only 51 years. We rode the elevated train from northeast Philadelphia to the University of Pennsylvania.

I am substantially older than Judge Becker. He was a freshman when I was a senior. He started at the University of Pennsylvania in the fall of 1950, and I had the opportunity to coach the University of Pennsylvania debating team when Judge Becker was a senior.

We went to Boston to debate the Norfolk State prisoners, Senator Kennedy, and the subject was resolved that the communist party should be outlawed. The five chief editors from the newspapers—Irwin Cannon was one of the judges of that debate, and I am not pleased to tell you that Judge Becker and I lost to the Norfolk State prisoners. We had a very large audience, about 1,000 inmates.

Senator KENNEDY. Which side were you on, Senator?

[Laughter.]

Senator SPECTER. They had to take the side of law and order to urge outlawing the communist party. We had 1,000 people. That is what you call a real captive audience, the quintessential.

Judge Becker graduated Phi Beta Kappa from the University of Pennsylvania and the Yale Law School, where again we were together in the law school. He graduated in the class of 1957 and he had a very unusual career as an active lawyer, a business lawyer, a trial lawyer, and a Republican committeeman.

I would say that Judge Becker is one of the few, if not the only Federal judges to have earned his judgeship both ways, by merit and by politics. It was a confluence of factors. He was on the United States District Court for the Eastern District of Pennsylvania at the age of 37, and he was elevated to the Third Circuit in 1970 and he is now the Chief Judge, bringing an enormous number of innovative ideas, one of the real leaders of the American bar and the American judiciary. If there should ever be another vacancy on the Supreme Court of the United States, we could start the confirmation hearing this morning.

As you can tell, Mr. Chairman, it is a long, very intimate friendship with Chief Judge Becker, and I know that he has some words of wisdom for the committee.

Thank you very much, Senator Hatch, for permitting me to go out of order.

Chairman HATCH. Thank you for your kind introduction, Senator Specter.

That is high praise Judge Becker, and, of course, I am very familiar and aware of you, as well, and have equally high esteem for you.

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM THE STATE OF UTAH

Chairman HATCH. I would just say good morning to everybody. We welcome you to today's hearing on bankruptcy reform. We would first like to thank all of our witnesses for their time and cooperation, and I hope that this hearing will serve to reinforce for all of us, especially the new members of the committee, the pressing need for bankruptcy reform.

Of course, bankruptcy reform is by no means a new issue to this committee or to the Congress. In fact, the Senate literally has been engaged in the process of deliberating on this issue for years, with numerous hearings, markups, and votes. And we should have these real and needed reforms and compromises that we have made to this product, one that has been supported by both Houses of Congress with overwhelming bipartisan and veto-proof margins.

Following extensive studies by the National Bankruptcy Review Commission, the comprehensive bankruptcy reform bill was developed by Senators Grassley and Durbin in the Subcommittee on Administrative Oversight and the Courts in 1997. We marked up and reported that bill out of committee in May 1998.

In September 1998, the Senate passed bankruptcy reform by a vote of 97 to 1. This overwhelming Senate vote in favor of bankruptcy reform was followed by the appointment of conferees, negotiation with the House and, in October 1998, a 300–125 House vote for the conference report.

Although the motion to proceed to consideration of the conference report was agreed to in the Senate by a strong vote of 94 to 2, the Senate ran out of time for a vote on final passage before the end of that Congress. So in February 1999, Representative George Gekas, in the House, introduced bankruptcy reform again, which passed out of the House in May 1999 by another overwhelming vote of 313 to 108.

Meanwhile, in the Senate, Senator Grassley worked together with Senator Torricelli, and in March 1999 once again introduced bankruptcy reform legislation which was again referred to the Judiciary Committee. The Judiciary Committee again marked up the bill, and in May 1999 we favorably reported it out of the committee to the floor.

In February of last year, the reform legislation passed the Senate by another impressive margin of 83 to 14. The Senate requested a conference, but the objection of a single member from the other side of the aisle blocked the appointment of conferees. As a result, we had to turn to an informal conference process with the House of Representatives, but fortunately this process was bipartisan. With a great deal of dedication of members on both sides of the aisle, we reached a compromise agreement on well over 400 pages of bankruptcy reform legislation and on all but two issues among the informal conferees.

In October of 2000, the House passed the bankruptcy reform conference report, and in December the Senate passed it by yet another overwhelming vote of 70 to 28. Later that month, the President pocket-vetoed the bankruptcy reform legislation.

Now, I provide this elaborate procedural history to make two points. First, the issue of bankruptcy reform is not a new one; it is quite familiar to all of us. Many of our witnesses today have testified before Congress on this issue. We have studied it, held hearings on it, compromised on it, and come to a resolution on it with veto-proof margins in both Houses time and again. An elaborate record sets out the issues, documents the debate, and makes the compelling case for reform that is available to anyone who has an interest in giving it their attention.

This leads me to my second point. Eventually, the process of deliberation needs to come to a close and the will of the Congress needs to be exercised. As history has demonstrated repeatedly, bankruptcy reform is clearly the will of the Congress and much needed for all American consumers.

I would like to take a moment to thank Senators Grassley and Sessions for their hard work and dedication to this important reform legislation over the past years. I also would like to thank the committee's ranking Democrat member, Senator Leahy, along with Senators Biden and Durbin, and Senator Torricelli, for their leadership in the area of consumer bankruptcy reform, as well as other members of the committee, both current and former, who have worked so hard on this very important set of issues.

I am feeling somewhat like a broken record, but I feel compelled to state once again that we cannot afford to continue down the harmful path provided by current law, because abusive bankruptcy filings are harmful to all of us. Bankruptcy ends up costing all Americans in an amount that has been conservatively estimated at anywhere from $400 to $550 per household, per year.

Contrary to what critics of reform would like us to believe, when someone files for bankruptcy the negative repercussions go far beyond the credit card companies and big businesses to whom money is owned but is not paid. The costs are passed on to all honest consumers who honor their commitments and who pay their bills. This is an issue that profoundly impacts the average American. Bankruptcies end up hurting people who own or work in small businesses, who are members of credit unions, and spouses and children who are entitled to child support.

We should preserve bankruptcy to provide a fresh start, but only for those who truly don't have the means to pay some of their debts as promised. I look forward to the testimony today because I believe it will highlight some of the abuses that the current system allows to take place and will address one more time the pressing need for this consumer bankruptcy reform which more importantly provides many new consumer protections.

We are fortunate to be hearing testimony from Judge Edward Becker, Chief Judge of the United States Court of Appeals for the Third Circuit, who has some concerns about the bill, some suggestions for us, and who we decided to put on at the last minute at the request of other members of the Federal judiciary and Judge Becker.

We are happy to welcome you here, Judge.

We have Judge Randall Newsome, of the United States Bankruptcy Court for the Northern District of California; Philip Strauss, Principal Attorney from the San Francisco Department of Child Support Services; Brady Williamson, the former Chair of the National Bankruptcy Review Commission.

We are also fortunate to be hearing from Ken Beine, President of Shoreline Credit Union, in Two Rivers, Wisconsin; Dr. Robert Manning, Senior Research Fellow from the University of Houston Law Center; Dean Shaeffer, Vice President and Director of Credit for Boscov's Department Stores, in Pennsylvania; Maria Vullo, an attorney with the firm of Paul Weiss; and Todd Zywicki, Assistant Professor Law at George Mason University.

We appreciate all of you appearing today and we look forward to your testimony.

I will now turn to our Ranking Member, Senator Leahy, for his opening statement.

OPENING STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM THE STATE OF VERMONT

Senator LEAHY. Thank you, Mr. Chairman. I know others perhaps have things to say, but I am pleased that we are having this.

There are so many competing public policy interests between debtors and creditors and among competing creditors. Judge Becker has seen those competing interests probably more than any one of us around this panel. But we also have a number of Senators around this committee who have developed expertise in this area and I do want to hear from them, too, because they are going to have to help us develop a consensus.

We have tried for 4 years to pass bankruptcy reform legislation. We all agree that we need some changes in the bankruptcy laws, but it has failed, I think, each time in the last two Congresses when we went from bipartisanship to partisanship.

In the last two Congresses, the final decisions were made by the Republican majority behind closed doors and did not get too much of a say in it. There are complex and competing interests in this that say we have to work in a bipartisan fashion throughout this process.

I would think that what we should do is look at some of the mistakes in the past and why we didn't get legislation through. I think we can avoid those mistakes. Mr. Chairman, I think you and I can work very closely together with other members of the committee to have both sides heard.

I think the last two times, we saw that there is a great deal of bipartisan consensus, and we can follow up on that. So I hope we do this and craft a balanced and fair bankruptcy reform law, one that addresses and corrects abuses by both debtors and creditors. For example, we should provide for more disclosure of information so that consumers may better manager their debts and avoid bankruptcy altogether.

I know that Senator Grassley and Senator Durbin, who is unable to be here today because of a death in the family, and Senator Schumer and others share a commitment to include credit industry reforms in a fair and balanced bankruptcy bill.

The millions of credit card solicitations made to American consumers the past few years have contributed to the rise in consumer debt and bankruptcies. When we see people who work here, their 3-year-old and 4-year-old children getting credit card solicitations, you know that something is wrong.

In addition, many of the most controversial proposals for change are to benefit the credit card industry and to use taxpayer-supported bankruptcy courts and the authority of Federal law to augment and support the credit card industry's debt collection. Well, if we are going to have the taxpayers help with their debt collection, it is only fair that the credit card industry be involved in bankruptcy reform and that they be asked to show how those changes they seek are going to benefit consumers through lower interest rates or lower fees. If we are going to help them collect their debt, if we are going to have the taxpayers pay to help them collect their debts, what are they going to do to help the users of their cards?

President Bush underlined the importance of examining credit industry practices. He said this week, to quote President Bush, "The debt I am most concerned about, however, is the consumer debt, credit card debt, the debt that burdens thousands of Americans. And we'd better be really careful about not recognizing the combination of an economic slow-down, high energy prices, and debt overhang—what that means to working people." As usual, I agree with President Bush.

I am pleased that Professor Robert Manning is here today to discuss his recent research and analysis of credit industry practices and consumer debt. We should also talk about wealthy debtors who use the overly broad homestead exemption to shield assets from their creditors. Senator Kohl has been a leader on this issue and on closing this loophole.

In some States, wealthy debtors have used their State laws to protect million-dollar mansions from creditors, and it has been a major problem. In the last Congress, by a vote of 76 to 22, the Senate adopted a bipartisan amendment offered by Senator Sessions and Senator Kohl to cap any homestead exemption at $100,000. But, of course, in the final bill that was gutted. Brady Williamson, the former Chair of the National Bankruptcy Review Commission, is here to tell us about this consensus reform and others like it that the Bankruptcy Review Commission recommended to Congress.

A year ago, the Senate passed the Schumer-Leahy amendment to prevent the abuse of the bankruptcy system whereby you could discharge penalties for violence against family planning clinics.

As I recall, Senator Schumer, that was a vote of 80 to 17, overwhelming. It was given support this past month by Senator Ashcroft, who had voted in favor of the amendment. He said he supported this. Yet, even though it was an overwhelmingly bipartisan endorsement, in the so-called conference report at the end of the year there wasn't a single word of it. As a result, perpetrators of clinic violence can continue to seek shelter in the Nation's bankruptcy courts. That would be wrong.

Attorney General Ashcroft pledged his support for the Schumer-Leahy amendment during his confirmation hearing. As usual, I agree with Attorney General Ashcroft.

I want you to notice my close agreement with President Bush and Attorney General Ashcroft in these matters, Senator Hatch, and I hope you will follow the example of the leaders of your party.

Maria Vullo, a top-rated attorney, will testify about the need to amend the Bankruptcy Code to stop wasteful litigation and abuse of bankruptcy filings used to avoid the legal consequences of violence and vandalism and harassment and to deny access to legal health services. So we should remember those things we passed in the past and look back at them.

We should also remember those who use bankruptcy are usually the most vulnerable of the American class. They are older Americans who have lost their jobs or are unable to pay their medical debts. They are women attempting to raise their families or secure alimony and child support after a divorce. They are individuals struggling to recover from unemployment. We need to remember that people use the system, both the debtor and the creditor.

Judge Becker and Judge Newsome are here today to testify about how reform legislation will impact on the real people who use our courts each day, and I think that is very helpful to us. We need to balance the interests of creditors with those of middle-class Americans who need the opportunity to resolve overwhelming financial burdens.

Even though this was put together on very, very short notice, the minimum notice, I am glad that the witnesses were able to come here today. I know the House is going to hold 2 days of meetings and amendments. I hope that we will work as hard as they do, but I would also hope that we would look at those things that were developed through bipartisan consensus in the last couple of years and go back to those things as a beginning point.

Thank you, Mr. Chairman.

Chairman HATCH. Thank you, Senator Leahy.

[The prepared statement of Senator Leahy follows:]

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM THE STATE OF VERMONT

I am pleased that the Committee is holding this hearing. Bankruptcy is a complex area of the law with many competing public policy interests between debtors and creditors and among competing creditors. I look forward to hearing our witnesses share their insight and experience with the current bankruptcy system. We are fortunate to have a number of Senators on this Committee who have developed expertise in this area, as well. I look forward to hearing from them, to working with them and to our developing a consensus of the areas of our federal bankruptcy law that need modification and improvement.

For the past four years, Congress has tried but failed to pass bankruptcy reform legislation. I believe the legislative process broke down in the each of the last two Congress when partisanship took over. Three years ago, as the Senate was considering bankruptcy legislation, I received assurances that our conferees would support the Senate bill and the Senate position in conference. Unfortunately, that bill, which passed with 97 bipartisan votes, and on which Senator Durbin and Senator Grassley had worked so hard, was abandoned to a poor substitute that was never enacted.

Last Congress, we again worked for a bipartisan bill. The Republican leadership extended Senate consideration of the bill over both congressional sessions when it would not allow votes on two proposed amendments in 1999. After the new year we returned to see the Senate vote overwhelmingly in favor of one of those amendments, the Schumer-Leahy amendment. During Senate consideration we also were able to improve the bill by adopting the Kohl-Sessions amendment, capping the homestead exemption.

Because of a Republican amendment that added unnecessary tax provisions, the House would not conference on the Senate-passed bill and no formal conference was conveyed. For a time we worked informally to resolve differences on a bipartisan basis, until the Republican majority decided to write their own version of a final bill that they had been warned would result in a presidential veto. They then used a sham conference to substitute their bankruptcy bill for a State Department embassy security bill. That bill dropped the Schumer amendment, revised the homestead exemption and did not address the oft-articulated concerns of the President, and the exercise predictably resulted in a veto rather than enactment. Unfortunately, at the end of each of the last two Congresses, final decisions were made by the Republican majority behind closed doors.

The complex and competing interests involved in achieving fair and balanced reforms of our bankruptcy system demand that we work in a bipartisan manner throughout the legislative process. That is the lesson to learn from the failed attempts of past reform measures, and it is all the more relevant as we begin this session with an evenly divided Senate and an evenly divided Committee. I hope that the partisan mistakes of the past will give way to real and sustained cooperation so that this Congress can produce a consensus that can make changes that are needed to benefit the American people. There is ample evidence from the last two rounds that bipartisan consensus is possible on responsible bankruptcy reform.

I look forward to working with all Members of this Committee in a respectful, bipartisan way from beginning to end—from hearings, to consideration of legislative ideas, to markup, to Committee report, to Senate consideration and finally to having a fair and balanced conference report signed into law. For us to succeed this time, we must work together from beginning to end.

I believe we can craft a balanced and fair bankruptcy reform law. One that addresses and corrects the abuses by both debtors and creditors in the current bankruptcy system.

For example, we should provide for more disclosure of information so that consumers may better manage their debts and avoid bankruptcy altogether. I know that Senator Grassley, Senator Durbin, Senator Schumer and others share a commitment to include credit industry reforms in a fair and balanced bankruptcy bill. The millions of credit card solicitations made to American consumers the past few years have contributed to the rise in consumer debt and bankruptcies. In addition, many of the most controversial proposals for change are to benefit the credit card industry and use taxpayer-supported bankruptcy courts and the authority of federal law to augment and support their debt collection. As a result, it is only fair that the credit card industry be involved in bankruptcy reforms and be asked to show how those changes they seek will benefit consumers through lower interest rates and lower fees.

President Bush underlined the importance of examining credit industry practices when he said this week: "The debt I'm most concerned about, however, is the consumer debt, credit card debt, the debt that burdens thousands of Americans. And we'd better be really careful about not recognizing the combination of an economic slowdown, high energy prices and debt overhang—what that means to working people." I agree with President Bush. I am pleased that Professor Robert Manning is here today to discuss his recent research and analysis of credit industry practices and consumer debt.

Another improvement we should make is to adequately address the problem of wealthy debtors who use overly broad homestead exemptions to shield assets from their creditors. Senator Kohl has been a leader on this issue and a champion of closing down this loophole for the rich. In some states, wealthy debtors have used their State laws to protect million dollar mansions from creditors. This has been a real abuse of bankruptcy's fresh start protection.

In the last Congress, the Senate overwhelmingly voted to close this loophole in the Bankruptcy Code. By a vote of 76 to 22, the Senate adopted a bipartisan amendment offered by Senators Kohl and Sessions to cap any homestead exemption at $100,000. But last year's final bill gutted this key reform. I am pleased that Brady Williamson, the former Chair of the National Bankruptcy Reform Commission, is here to tell us about this consensus reform and others like it that the Bankruptcy Reform Commission recommends to Congress.

Last year's final bill also failed to address the discharge of penalties for violence against family planning clinics. A year ago this month, the Senate passed the Schumer-Leahy amendment to prevent this abuse of the bankruptcy system by a vote of 80–17. We have been reminded of this vote often during the past month given Senator Ashcroft's vote in favor of the amendment. Despite this overwhelming bipartisan endorsement, last year's so-called conference report contained not a single provision to end the abusive practice. As a result, perpetrators of clinic violence can continue to seek shelter in the nation's bankruptcy courts. That would be wrong.

Attorney General Ashcroft pledged his support for the Schumer-Leahy amendment during his confirmation hearings. Today, Maria Vullo, a top-rate attorney, will testify about the need to amend the Bankruptcy Code to stop wasteful litigation and end abusive bankruptcy filings used to avoid the legal consequences of violence, vandalism and harassment to deny access to legal health services.

As we proceed with this legislative process, we should remember the purpose bankruptcy serves, which is as a safety net for many Americans. Those who use bankruptcy are the most vulnerable of the American middle class.

They are older Americans who have lost their jobs or who are unable to pay their medical debts. They are women attempting to raise their families or secure alimony and child support after a divorce. They are individuals struggling to recover from unemployment.

As we move forward with reforms that are appropriate to eliminate abuses in the system, we need to remember the people who use the system, both the debtor and the creditor. Judge Becker and Judge Newsome are here today to testify about how reform legislation will affect the real people who use our courts every day.

We need to balance the interests of creditors with those of middle-income Americans who need the opportunity to resolve overwhelming financial burdens. As the last two Congresses proved, there are many competing interests in the bankruptcy reform debate that make it difficult to enact a balanced and bipartisan bill into law.

Although this hearing was scheduled unilaterally with the minimum notice allowed under Senate rules, I thank our witnesses for responding to the call on such short notice to be with us today. We did not receive the names of the four witnesses invited by the Republicans until Monday afternoon. We did not begin receiving written statements from those witnesses until yesterday afternoon. Accordingly, I expect that we will have written follow up questions to be forwarded to these witnesses within a reasonable time of reviewing their written statements and of reviewing their comments here today.

I note that the House Judiciary Committee has chosen to hold two days of hearings on this important topic. I understand that the House Judiciary Committee has also indicated that it intends to hold two days of meetings for discussion and amendment of the House bill. I look forward to working with Chairman Hatch on a schedule that would allow our Committee, the Senate Judiciary Committee, likewise to do its work and serve the Senate by fully and fairly considering legislation on bankruptcy related issues. These are important subjects that can have a great impact on the lives of many people who have already suffered from illnesses or divorce or job loss or other personal difficulties. We ought to take utilize the expertise of the Members of our Committee to ensure that what we report to the Senate is fair and balanced and that it will not exact an unintended toll on our neighbors.

I am hopeful that this year, we will work together in a bipartisan fashion from the beginning of the legislative process to the end to enact reforms that ensure our bankruptcy laws better serve their intended goals and corrects abuses by both debtors and creditors in the bankruptcy system.

Senator BIDEN. Mr. Chairman, nothing on the merits, but may I also welcome Chief Judge Becker?

Chairman HATCH. Sure.

Senator BIDEN. I consider him a friend and I just want to associate myself with the remarks of Senator Specter. The Third Circuit is the circuit in which Delaware resides, and I want to thank the judge for all he has done for the circuit and accommodating the movement of some judges onto that circuit from the State of Delaware. Again, I would like to associate myself with the remarks of Senator Specter. I will not take any more time.

Senator LEAHY. As do I. I think we are fortunate to have Judge Becker. Even though he has to sit here and listen to all these speeches, I think we are darn lucky to have him here.

Chairman HATCH. Judge, we are happy to have you here and we will turn the time over to you. We appreciate and respect the work you do on the Third Circuit as Chief Judge. We will turn the time to you and we want to listen very carefully to what you have to say.

STATEMENT OF HON. EDWARD R. BECKER, CHIEF JUDGE, UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT, PHILADELPHIA, PENNSYLVANIA

Judge BECKER. Thank you, Mr. Chairman. For the record, my name is Edward Becker. I am the Chief Judge of the United States Court of Appeals for the Third Circuit and a member of the Executive Committee of the Judicial Conference of the United States, on whose behalf I appear here today. Let me state, Mr. Chairman, we are very grateful for your making this spot available to us, and the other members of the committee.

Let me state at the outset that I am here not to discuss general matters of debtor and creditor, but about some other real people in our society, Federal judges, and the institution of the Federal judiciary and the impact of one provision of this legislation. I am here to talk only about Section 1235, that dealing with bankruptcy appellate procedure. That provision would effect a radical change in bankruptcy appellate procedure by routing virtually all bankruptcy appeals which now go to the district courts directly to the courts of appeals.

Now, if there is one thing I know a little bit about after 20 years on the courts of appeals, and actually 30 years on the Federal bench, it is about the workload of the courts of appeals. We are stretched, we are strained, we work all the time. We are at our limit, and we simply cannot absorb this new load of all of these bankruptcy appeals.

It may be quite unusual, but I am here not just on behalf of the Executive Committee, but I have spoken to every chief circuit judge, that is the chief circuit judges of all of the regional circuits who hear bankruptcy appeals. Each and every chief circuit judge—and they are the ones who are responsible for management of litigation in the courts of appeals, and as you know, we are basically the court of last resort in this Nation because the Supreme Court doesn't hear very many cases. Each and every chief judge opposes this provision and has authorized me to speak on their behalf.

Now, we are not sure of the exact numbers. Our best estimate is probably 3,000 more appeals a year. The heaviest impact would be on a number of circuits. Frankly, it would be on the First Circuit, Senator Kennedy's circuit; the Second Circuit, Senator Leahy and Senator Schumer's circuit; the Third Circuit, Senator Biden's and my circuit; the Sixth Circuit; the Tenth Circuit, Senator Hatch's circuit; and the Ninth Circuit, Senator Feinstein's circuit. In terms of the numbers, we estimate an increase in caseload between 10 and 20 percent.

Having mentioned the Ninth Circuit, I spoke to Chief Judge Schroeder yesterday, who is especially concerned about the impact of this legislation on the bankruptcy appellate panels which they have so carefully honed, because essentially if there is the option to go right to the court of appeals, she is fearful that the BAPs, as they call them, will be simply bypassed and that that structure will fall into disuse.

Some say, well, give us more judges to take up these additional cases. Well, this committee knows better than anybody the history of more judges. The First Circuit hasn't had a new judge since 1984, and they have a sizable increase. The Second Circuit would have a 40-percent increase. But I don't want to go into all of those details.

Let me get down to the matter that this body is concerned about. You are a policymaking body and you deal with costs and benefits. Now, I have talked about the cost. In our view, the cost would be incalculable in terms of the burdens on the courts of appeals and the need for more judges, which we are not going to get and we shouldn't get for this purpose.

Let me talk about the benefits. Now, this proposal which was endorsed by the National Bankruptcy Review Commission is offered as a simple, neat solution. We say we have a two-tiered appeal. We have one appeal to the district court or the bankruptcy appellate panel and another to the court of appeals, and this is a simple, neat solution.

I hope that the committee will not feel I am irreverent when I say that to every human problem there is a solution that is simple, neat and wrong, and this one is wrong. First of all, there are legal problems with it. I take no position on this as an Article III judge, but the Department of Justice has long taken the position that this has constitutional problems. They believe that meaningful review in the district court is necessary for it to be constitutional and query whether the 30 days is meaningful review.

Second, this is offered that we need more precedent; bankruptcy opinions are all over the lot. Give it to the court of appeals and there will be more precedent. That is the theory. The theory is that if we have more precedent, we will have less litigation. I can tell you, after 30 years on the Federal bench, more precedent only means more litigation, that being the nature of the beast in terms of lawyers.

And precedent isn't the kind of precedent you make in terms of broad rules. All precedent is is the decisions are fact-bound; it is very narrow. All you do is deal particularly with the facts of the case, and the facts of the case generally are pretty fact-bound and they don't help anybody. Additionally, the courts of appeals are so burdened that when we decide cases, most of them we decide as non-precedential. So you don't get precedent when you get to the court of appeals these days because we are so busy.

I can run through my other points very quickly, with your permission, Mr. Chairman. With respect to cost, it is said that this would be a cheaper way if you have a unitary appeal process. But the fact of the business is that it is much more expensive to take a case to the court of appeals because of our briefing and all of the requirements. The district court procedures are simpler, they are much cheaper, and 80 percent of the cases fall out. We talk about two tiers, but 80 percent of them are gone at the district court level.

The district courts are doing a good job, so you are making it more expensive if you do this in terms of time. It is certainly not easier for the 80 percent because you lengthen the period with the additional 30 days that are in the statute.

I concede that in some complex cases the two tiers will take longer. They are basically adversary proceedings. In Chapter 11, they are traditional, complex litigation. We don't deny that is a problem and we have offered a solution. Instead of this broad-based solution which is an over-broad solution, we offer a targeted solution. And we don't want to stop this bill. The Congress wants to pass a bill.

All we say is substitute for that bankruptcy appellate provision a simple provision which says that if the district court or the bankruptcy appellate panel certifies to the court of appeals that this is a time-sensitive problem—we have got a reorganization that is going to stand or fall, we need a decision—or if there is a precedent that has to be established, let it be certified to the court of appeals.

Our proposed bill says that acceptance of the certification is up to the court of appeals. We think that is more sound, but I am authorized by the Executive Committee to say that the committee feels that we are bound by the certification. If the district court or the bankruptcy appellate panel says the interests of justice require you to take this case, then we will take it and then we will establish precedent.

So we think that is a targeted solution and we think that is by far the best solution, and we urge the committee and the Congress to jettison 1235, as written, and adopted this alternative proposal which is, as I say, approved by the Judicial Conference. We think it will really solve the problem.

My statement talks about filing fees, data collection, income tax returns, bankruptcy rules. We think there are some other burdens imposed on the court, but I don't want to take the time of the committee. I will leave that to my statement.

We also urge additional bankruptcy judges. I know that is a matter Senator Biden is concerned about, and we are because of the huge bankruptcy load in Delaware. We need more bankruptcy judges, but they need them a lot of places. I will leave those matters to the statement.

I thank you so much, Mr. Chairman, and, of course, if anybody has any questions, I would be pleased to answer them.

Chairman HATCH. Well, thank you, Judge. This Senator is sympathetic to what you are saying, and your statement, I think, covers this very, very well.

Unless there are any questions, we appreciate your coming very much.

Judge BECKER. Thank you so much.

Chairman HATCH. And we appreciate your taking time out of, we know, a very busy schedule. Thank you for being here.

Senator LEAHY. Mr. Chairman, I would just note I think a couple may have some short questions in writing for Judge Becker.

Judge BECKER. Of course.

Chairman HATCH. We will keep the record open, Judge.

Senator BIDEN. That is what I was about to ask.

Senator LEAHY. We like having your expertise available to us, so thank you very much.

Judge BECKER. Thank you so much.

Chairman HATCH. Thanks so much.

We are grateful to have had Judge Becker with us today and that we could accommodate his schedule.

[The prepared statement and an attachment of Judge Becker follow:]

STATEMENT OF HON. EDWARD R. BECKER, CHIEF JUDGE, UNITED STATES COURT OF APPEALS, THIRD CIRCUIT

Mr. Chairman and members of the Committee:

My name is Edward Becker, and I am the Chief Judge of the United States Court of Appeals for the Third Circuit. I appear before you as a member of the Executive Committee of the Judicial Conference of the United States to present the position of the Judicial Conference with regard to S. 220, the "Bankruptcy Reform Act of 2001." I thank you for the opportunity to appear today and would like to address six areas of concern to the judiciary: appeal of bankruptcy court decisions, need for new judgeships, re-allocation of revenues generated by filing fees, mandatory data collection, filing of tax returns with the bankruptcy court, and amendment of bankruptcy rules.

DIRECT APPEALS

The Judicial Conference strongly opposes section 1235 of the bill regarding expedited appeal of bankruptcy cases. As proposed, this provision would revise the basic structure for appeals from the orders of the bankruptcy court by providing that all bankruptcy court orders appealed to the district court would become orders of the district court 31 days after such appeal is filed, unless the district court decides the case within 30 days or extends the time period for decision. Functionally, this will result in all appeals from bankruptcy courts being routed directly to the United States Court of Appeals, depositing some four thousand new cases per year on these courts.

Turning first to the provisions of section 1235, I note that, as a general matter, the Judicial Conference opposes statutory litigation priorities, expediting requirements, or time limitation rules in specified types of civil cases beyond those few categories of proceedings already identified in 28 U.S.C. § 1657 as warranting expedited review.[1] Mandatory priorities and expediting requirements run counter to principles of effective civil case management. Individual actions within a category of cases inevitably have different needs for priority treatment and are best determined on a case-by-case basis. In addition, as the number of categories of cases receiving priority treatment increases, the ability of a court to expedite review of any of these cases is restricted. Because 28 U.S.C. § 1657 already authorizes the court to expedite a proceeding if "good cause is shown," additional restrictions on federal courts are unnecessary.

[1] Report of the Proceedings of the Judicial Conference of the United States, September 1990, p. 80.

Beyond creating general case management problems by imposing such a time limit on the district courts, the particularly short time limit imposed by the proposed legislation would undermine the administration of justice. The district court would be required either to extend the 30 day period as a matter of routine or to make a determination as to whether direct appeal is appropriate or not within the 30 day period. The 30 day period running from the date of filing the appeal is patently insufficient to allow practitioners the time needed to adequately brief the issue, much less to allow the district court adequate time for review. It is clear to me that, as a practical matter, this provision requires direct review of these cases in the court of appeals. The 30 day layover in district court only increases costs to the litigants and will prove to be a meaningless step on the way to review by the court of appeals.

The Judicial Conference has concluded that the inevitable result of this provision will be to saddle the courts of appeals with thousands of new cases. According to a study of the Federal Judicial Center, it has the potential to increase bankruptcy appeals by 400%. The circuit courts now handle approximately 1,000 bankruptcy appeals each year. Under the proposed procedure, the courts may be faced with 4,000 new cases annually. Such a precipitous increase in the caseloads of the courts of appeals is utterly unprecedented. All of the chief judges of the twelve regional circuit courts of appeals strongly oppose this provision. Many of these courts maintain incredibly high workloads while being chronically shorthanded. A significant increase in the volume of bankruptcy appeals exacerbates a grievous problem and negatively affects the prompt and effective processing of all appeals.

The proposal is particularly unfair to parties to a bankruptcy appeal. It will most certainly increase the cost of the appeal. Practice, including briefing, is more complicated and time consuming in appellate courts than in district courts. Attorney fees and other costs to the parties will increase in 80% of all appeals, the percentage of appeals that currently proceed no further than the district courts. Further, appeals are handled far more expeditiously in district courts than in courts of appeals. Indeed, the current system is working well; the district judges by and large do a good job with these cases. In sum, the proposal provides for increased expense and increased delay for parties to a bankruptcy appeal, and attempts to fix something that “ain't broke.”

The Judicial Conference recommends a proposal for expedited appeal of a targeted number of bankruptcy cases which is attached hereto. This proposal redresses the primary complaints regarding the existing statutory scheme for bankruptcy appeals: the need for expeditious final disposition of appeals in time sensitive cases (where the success of a reorganization depends upon a quick decision), and putative inefficiency in the development of binding precedential case law.[2] The Judicial Conference proposal will solve these problems without creating the aforementioned unnecessary problems for litigants and the courts of appeals.

The Conference position is that bankruptcy court orders should be reviewable directly in the courts of appeals if, upon certification from the district court or bankruptcy appellate panel, the court of appeals determines that (1) a substantial question of law or matter of public importance is presented and (2) an immediate appeal to the court of appeals is in the interests of justice. This would allow direct appeal where necessary to establish precedential case law and meet special needs of parties, while leaving intact the basic bankruptcy appellate structure. Most bankruptcy appeals are currently resolved effectively by the district courts or by the parties, as shown by a Federal Judicial Center review reflecting that 73% of bankruptcy appeals in the district courts were resolved with little or no judicial involvement. By preserving the district court as a forum for meaningful review, the Conference proposal satisfies two objectives-it allows for timely resolution of appeals at minimal cost to litigants, and it facilitates the establishment of precedential case law in bankruptcy without placing undue burdens on the courts of appeals.

JUDGESHIPS

Section 1225 of the bill would create 23 new temporary bankruptcy judgeships and extend the existing temporary judgeships in the northern district of Alabama, the district of Puerto Rico, and the eastern district of Tennessee for a period of three years, and extend the existing temporary judgeship in the district of Delaware for a period of five years. The section also contains a provision to extend the temporary

[2] The argument is made that direct appeals to the court of appeals will create more precedent AND that more precedent will lead to more certainty in the law and less litigation. My thirty years experience on the federal bench tells me that the opposite is true. More precedent leads to more litigation.

judgeship in the district of South Carolina for a period of three years. Because the term of South Carolina's temporary judgeship lapsed on December 31, 2000, however, the bill will no longer have its intended effect with regard to that judgeship. The term of a judgeship that no longer exists cannot be extended. Therefore, the bill needs to "re-authorize" that judgeship by including it among the new judgeships created by the bill.

The bill falls somewhat short of the needs of the judiciary. The Judicial Conference recommends authorization of 23 judgeships provided for in the bill, as well as an additional judgeship in the district of Maryland and a judgeship in the district of South Carolina to replace the lapsed judgeship. In addition, the Conference urges that 13 of these judgeships be established on a permanent basis [3] and the other 12 on a temporary basis;[4] that the current temporary judgeships in the district of Puerto Rico, the northern district of Alabama and the district of Delaware be converted to permanent positions; and, that the temporary judgeship in the eastern district of Tennessee be extended for a period of five years.

The Judicial Conference is required by law to submit recommendations to Congress regarding the number of bankruptcy judges needed and the districts in which such judgeships are needed.[5] This requirement has engendered a process whereby the need for additional judgeships is assessed on a biennial basis. The bankruptcy and district courts provide recommendations to their respective judicial councils. The judicial councils' recommendations are then subject to onsite surveys of the districts for which judgeships are requested.

Under the direction of the Conference Committee on the Administration of the Bankruptcy System, the surveys include a thorough review of the dockets in each respective court and interviews with the chief district judge, the bankruptcy judges, the bankruptcy clerk, the United States Trustee, and local bankruptcy attorneys. Suggestions for improvements in case management and methods to achieve greater efficiencies are solicited by the survey team. The survey team then prepares a written report and recommendation regarding each respective district that is submitted to the Committee's Subcommittee on Judgeships. The Subcommittee reviews each request for additional judgeships and survey report and then forwards these materials, with its recommendation, to the requesting appellate, district and bankruptcy courts for additional comment. All relevant materials are then provided to the full Committee, which makes recommendations to the Judicial Conference. The Conference makes its determination on the need for each requested judgeship and then submits its recommendation to Congress.[6]

Various factors are considered in this process for determining the need for new judgeships. The most significant factor is the "weighted judicial caseload" of each bankruptcy court. This figure is derived from a formula established as a result of a time study of the bankruptcy courts conducted by the Federal Judicial Center during 1988 and 1989. Absent exigent circumstances, the Judicial Conference considers requesting an additional judgeship only when the caseload of a court exceeds 1500 weighted filings per judge. In those instances in which the addition of a judgeship would result in a decrease of the caseload below 1500 weighted filings, the Conference seeks a temporary position; in those instances in which the weighted filings would remain above 1500 per judge even with the addition of another judge, the Conference seeks a permanent position.

Other factors which are taken into consideration during this review process, especially in those districts with case weights near the 1500 weighted filings threshold, include the nature and mix of the caseload of the court; historical caseload data and filing trends; geographic, economic and demographic factors; effectiveness of the case management efforts of the court; and, the availability of alternative resources for handling the caseload of the court.

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[3] District of Delaware (1), District of New Jersey (1), District of Maryland (3), Eastern District of Virginia (1), Eastern District of Michigan (1), Western District of Tennessee (1), Central District of California (3), Southern District of Georgia (1) and Southern District of Florida (1).

[4] District of Puerto Rico (1), Northern District of New York (1), Eastern District of New York (1), Southern District of New York (1), Eastern District of Pennsylvania (1), Middle District of Pennsylvania (1), Eastern District of North Carolina (1), Southern District of Mississippi (1), Eastern District of California (1), Central District of California (1), Southern District of Florida (1) and District of South Carolina (1).

[5] 28 U.S.C. § 152(b)(2).

[6] It should be noted that in those instances in which Congress declines to authorize the requested judgeships, the on-site survey process is not necessarily repeated before the request is renewed. Nevertheless, review of each request is conducted to determine whether or not the underlying justification for the request has changed to the extent that an on-site survey should be repeated.

Additional bankruptcy judgeships have not been authorized by-Congress since 1992 when 35 new judgeships were approved. In response to a substantial increase in case filings, the Judicial Conference has made recommendations to Congress for additional bankruptcy judgeships in 1993, 1995, 1997 and 1999. These judgeships have not as yet been authorized by Congress.

The need for the required additional judicial officers is great. Bankruptcy filings continue at very high levels and well over a million cases are pending in our bankruptcy courts. While the judiciary employs a number of creative strategies to manage ever increasing caseloads, including the use of temporary bankruptcy judges, recalled bankruptcy judges, inter- and intracircuit assignments, additional law clerks, and advanced case management techniques, there remains a dire need for more judicial resources to handle the burgeoning judicial workload.

FILING FEES

Section 325 of the bill amends the statutory filing fees for chapter 7 and chapter 13 cases and re-allocates a portion of the revenues generated by such fees from the judiciary and the Treasury general fund to the United States Trustee program. This amendment will reduce revenues to the judiciary of approximately $5 million per year. While the Judicial Conference takes no position regarding the proposed reduction of revenue to the Treasury general fund, it strongly opposes reducing revenue currently allocated to the judiciary and providing it to the United States Trustees. The existing fee structure takes into account the significant costs the judiciary bears in administering the Bankruptcy Code. The costs of the United States Trustees are far exceeded by the costs of maintaining 324 bankruptcy judgeships and the staffs and facilities for these judgeships.

The current fee schedule took effect in December 1999.[7] That schedule reflects an increase of $25 in the filing fee for both chapter 7 and chapter 13 cases to a total of $155, and allocates the increased filing fee revenue equally between the judiciary and the United States Trustee program. Assuming total filings of approximately 1.3 million per year, as based upon fiscal year 2000 figures, this increase would annually generate approximately $16.25 million each for the judiciary and the United States Trustee program. The increase was enacted with an understanding by the Appropriations Committees that these funds were required by the judiciary to meet its current statutory responsibilities, without taking into account any additional funding that would be required to meet the new responsibilities imposed by the bankruptcy reform legislation.

This bill would further revise filing fees to $160 for chapter 7 cases and $150 for chapter 13 cases and reduce that portion of the filing fee that is allocated to the judiciary from $52.50 as provided under current law to $50.00 in chapter 7 cases and $45.00 in chapter 13 cases. Assuming the annual filing of approximately 900,000 chapter 7 cases and 400,000 chapter 13 cases, this provision would have the effect of reducing revenues to the judiciary by over $5 million per year, while increasing revenues to the United States Trustee program by over $7 million per year.

The Judicial Conference strongly opposes this re-allocation of revenues at a cost to the judiciary of more than $25 million over the next five years. Not only are these funds required by the judiciary to meet its current statutory responsibilities, but other provisions of this bill will require additional expenditures by the judiciary of an estimated $80 million during the same five year period. Moreover, revising filing fees that took effect only 14 months ago, with all the attendant administrative costs and disruptions, would seem to be an unwise expenditure of taxpayer funds.

DATA COLLECTION

Section 601 of the bill directs the clerks of court to collect, and the Administrative Office to compile and report, financial data of consumer debtors and certain categories of case event statistics in consumer bankruptcy cases. The Congressional Budget Office estimates that this requirement will cost the judiciary $30 million over the next five years.

The Judicial Conference is opposed to the provisions of the bill that direct the judiciary to collect and report financial data that is unnecessary to fulfill its responsibility to report to Congress and the public information on the adjudication of cases. Under these provisions, the financial data is to be derived from the schedules and statements filed by consumer debtors. This information, filed by debtors at the outset of bankruptcy cases and in many instances without the assistance of a law-

[7] Omnibus appropriations bill for fiscal year 2000 (Pub. L. No. 106–113).

yer, is, at best, of questionable reliability[8] Both assets and liabilities are frequently valued inaccurately by consumer debtors, and some debt simply cannot be valued definitively at the outset of the case because it is unliquidated, contingent or disputed. Therefore, these provisions will not generate "improved bankruptcy statistics," but will impose significant costs upon the taxpayers.

A far superior approach, in our view, is to append the responsibility to collect, compile and report financial data to the responsibility of the United States Trustees to conduct audits under the bill. This approach would have two significant benefits: it would yield audited, and thus accurate, data, and it would accomplish this at a fraction of the cost to the taxpayer. We believe that this data would meet the needs of Congress to conduct a continuing assessment of the functioning and effectiveness of the bankruptcy system. The staff of the Administrative Office is prepared to work with congressional staff to craft an appropriate replacement for the provision that currently appears in this legislation.

In the event Congress is committed to imposing the responsibility to collect, compile and report financial data upon the judiciary, we respectfully request extension of the date upon which this provision would take effect. Compliance with these new requirements will require revising official bankruptcy forms, developing new statistical data fields, training clerks in entering additional data into our computer systems, devising data extraction programs, and reprogramming Administrative Office statistical compilation programs. We will also have to coordinate with forms publishers and software developers so that the new forms can be made available to attorneys and debtors. In order for these responsibilities to be met in an accurate and thorough manner, we recommend that the provisions regarding collection and reporting of financial data be revised to take effect 24 months after enactment of the bill, with the first report due to Congress no later than 36 months after enactment of the bill.

The bill also requires the bankruptcy clerks and the Administrative Office to collect and report certain case event statistics. While the judiciary is the appropriate entity to collect and report this information, this responsibility would similarly pose a significant problem. Events occurring in bankruptcy cases are reported to the Administrative Office through the electronic case management systems of the courts. The current systems, however, are nearing the end of their useful lives and cannot collect additional information of the sort required by these bills. To upgrade these systems to meet the requirements of this legislation would require a major financial investment, contrary to good government and common sense, and divert resources from and delay the development and deployment of a new, modern electronic case management system that is in the process of being deployed in the bankruptcy courts.

This new system will not be installed and operating in all districts for at least three and a half years. Accordingly, if the judiciary is to be required to collect and report these case event statistics system-wide, we urge that this provision be revised to take effect 48 months after enactment of the bill, with the first report due to Congress no later than 60 months after enactment of the bill.

INCOME TAX RETURNS

The bill requires chapter 7 and chapter 13 debtors, upon request of a creditor, to file with the bankruptcy court copies of federal income tax returns for the three year period preceding the order for relief and for the period during which the case is pending. The bill further requires the court to limit access to the returns pursuant to security procedures promulgated by the Director of the Administrative Office and requires the court to destroy the returns three years after the case is closed.

Implementation of this provision would entail development and maintenance of a filing system separate from the public case files, with access limited to trustees and parties in interest. Court files, with the narrow exception of sealed records, are public records available on request. Because the sealing of records is relatively rare, sealed records can be easily segregated from the public case file. The routine filing of tax returns, however, would be problematic.

Recognizing that tax returns are not to be made available to the public, the bill requires the Director of the Administrative Office to establish procedures to safeguard the confidentiality of tax information and to establish a system to make the information available to the United States trustee, case trustee, and any party in interest. To carry out this-responsibility, it would be necessary to establish a separate filing system for tax returns in each clerk's office, as well as to provide person-

[8] See Report of the National Bankruptcy Review Commission, vol. 1, ch. 4 (October 20, 1997).

nel to manage it so that unlawful dissemination of this information would not occur. This would be a costly undertaking requiring additional office space and personnel.

As the United States Trustee's files are not public records, limiting access to trustees and parties in interest would not require segregating tax returns and creating separate procedures governing access to them. The Trustee's office also has personnel and procedures in place to deal with debtors. While the Trustees may well need some additional resources to meet this responsibility, that cost should be far less than the cost of establishing a new separate system in each clerk's office.

Accordingly, the Judicial Conference takes the position that the bankruptcy courts should not be required to maintain tax returns filed by debtors, which are typically of no use in the administration of bankruptcy cases. The Conference believes that responsibility for collection and maintenance of these tax returns would be more appropriately assigned to the United States Trustees, who are responsible for supervising and estates and approving distributions to creditors.

BANKRUPTCY RULES

Section 102 of the bill establishes standards governing sanctions for abusive filings that are inconsistent with Bankruptcy Rule 9011. In addition, section 319 states the sense of Congress suggesting several changes to Bankruptcy Rule 9011. The cumulative effect of the provisions will cause confusion and needless satellite litigation. Accordingly, they should be deleted from the bill.

There are six provisions in the bill that directly task the Supreme Court or the Judicial Conference or its Advisory Committee on Bankruptcy Rules to promulgate a bankruptcy rule or an official form to implement a new requirement added by an amendment of the Bankruptcy Code. Section 221 amends section 110 of the Code to require bankruptcy petition preparers to provide to the debtor a notice, the contents of which are detailed in section 110(2)(B). The provision states that the notice shall be an official form issued by the Judicial Conference. Section 419 requires the Judicial Conference's Advisory Committee on Bankruptcy Rules, after considering the views of the Executive Office for United States Trustees, to propose for adoption rules and forms to assist a debtor to disclose the value, operations, and profitability of any closely-held business. Section 433 requires the Advisory Committee to propose for adoption a standard form disclosure statement and plan of reorganization for small businesses. Section 435 requires the Advisory Committee to propose for adoption rules and forms for small-business debtors to file periodic financial and other reports. Section 716 expresses the sense of Congress that the Advisory Committee propose rules amending Bankruptcy Rules 3015 and 3007 to extend deadlines for governmental units to object to confirmation of chapter 13 plans and to restrict the rights of interested parties to object to tax claims until the filing of a required tax return. Finally, section 1234 takes the extraordinary step of amending the Rules Enabling Act to prescribe the form to assist a debtor to report monthly income and expenses required to implement amended section 521 of the Code.

These provisions are unnecessary because the Advisory Committee automatically reviews any legislation amending the Bankruptcy Code to identify and prescribe any needed amendments to rules and forms. More importantly, directing the Judicial Conference or one of its committees to amend a particular rule or form bypasses the initial stages of the Rules Enabling Act process and needlessly undercuts in varying degrees the proper role of the Judicial Conference and its committees, the bench and bar, the public, and the Supreme Court in that process.

CONCLUSION

In conclusion, the Judicial Conference urges the Committee to amend the legislation to replace the expedited appeal provision with the Judicial Conference proposal, to re-authorize the lapsed South Carolina judgeship and provide the other needed judgeships, to leave intact the current filing fee structure, to re-assign the responsibility to compile and report financial data and maintain tax returns to the United States Trustee program, which is better suited to meet these responsibilities, to extend the effective date for collection and reporting of case event statistics by the bankruptcy clerks and Administrative Office, and to delete the provisions regarding amendment of bankruptcy rules.

Again, thank you very much for this opportunity to appear before the Committee. I am prepared to answer any questions that you may have.

SEC.______BANKRUPTCY APPEALS

(a) APPEALS.—Section 158 of title 28, United States Code, is amended—

(1) in subsection (c)(1) by striking out "Subject to subsection (b)," and inserting in lieu thereof "Subject to subsections (b) and (d)(2),"; and

(2) in subsection (d)—

(A) by inserting "(1)" after "(d)"; and

(B) by adding at the end of that subsection the following new paragraph:

"(2) A court of appeals that would have jurisdiction of a subsequent appeal under paragraph (1) or other applicable law may, in its discretion, permit an immediate appeal to itself, in lieu of further proceedings in a district court or before a bankruptcy appellate panel exercising appellate jurisdiction under subsection (a) or (b), if the district court or bankruptcy appellate panel hearing an appeal certifies, that——

"(A) a substantial question of law or matter of public importance is presented in the appeal pending in the district court or before the bankruptcy appellate panel; and

"(B) the interests of justice require an immediate appeal to the court of appeals of the judgment, order, or decree that had been appealed to the district court or bankruptcy appellate panel."

(b) PROCEDURAL RULES.—Until rules of practice and procedure are promulgated or amended 19 under the Rules Enabling Act (28 U.S.C. §§ 2071–2077) to govern appeals to a court of appeals 20 exercising jurisdiction under section 158(d)(2) of title 28, as added by this Act, the following shall apply:

(1) A district court or bankruptcy appellate panel may enter a certification as described in section 158(d)(2) during an appeal to the district court or bankruptcy appellate panel under section 158(a) or (b).

(2) Subject to the other provisions of this subsection, an appeal by permission under section 158(d)(2) must be taken in the manner prescribed in Rule 5 of the Federal Rules of Appellate Procedure.

(3) When permission to appeal is requested on the basis of a certification of a district court or bankruptcy appellate panel, the petition must be filed within 10 days after the district 10 court or bankruptcy appellate panel enters the certification.

(4) When permission to appeal is requested on the basis of a certification of a district court or bankruptcy appellate panel, a copy of the certification must be attached to the petition.

(5) When permission to appeal is requested in a case pending before a bankruptcy appellate panel, the terms "district court" and "district clerk," as used in Rule 5 of the Federal Rules of Appellate Procedure, mean "bankruptcy appellate panel" and "clerk of the bankruptcy appellate panel."

(6) When a court of appeals grants permission to appeal, the Federal Rules of Appellate Procedure apply to the proceedings in the court of appeals, to the extent relevant, as if the appeal were taken from a final judgment, order, or decree of a district court or bankruptcy appellate panel exercising appellate jurisdiction under section 158(a) or (b).

SECTION-BY-SECTION ANALYSIS

Section.______Bankruptcy appeals

Currently, decisions of bankruptcy judges can be appealed either to—

(a) the district court for the respective district or

(b) to a bankruptcy appellate panel of three bankruptcy judges. Further appeals lie from the district court or bankruptcy appellate panel to the court of appeals for the circuit.

In practice, this approach to bankruptcy appeals has had difficulty fastening certainty and predictability in bankruptcy law. Unlike those of a court of appeals, decisions of a district court acting as an appellate court or a bankruptcy appellate panel have no stare decisis value or, in other words, are not binding beyond a particular case.

To address that problem without sacrificing the economy to the parties of review by a single district court judge, this section amends section 158 of title 28 to permit an appeal to be heard directly by the court of appeals if the district court or bankruptcy appellate panel certifies that——

(1) the appeal presents a substantial question of law or matter of public importance, and

(2) an immediate appeal to the court of appeals is in the interests of justice, and if the court of appeals agrees to hear the matter. Since this creates a new route of appeal, this section provides interim procedures until permanent rules can be prescribed under the Rules Enabling Act.

This section preserves the option of prompt, inexpensive review in the district court for cases in which the parties need it—*i.e.*, fact-intensive cases, small cases, and cases where the parties only want a quick "second look" by another source. It also provides for direct review by the court of appeals so that binding precedent can be created in those cases and for those issues meriting that treatment, without flooding the courts of appeals with all bankruptcy appeals.

Chairman HATCH. Our panel will be Judge Randall J. Newsome, United States Bankruptcy Court of the Northern District of California, in Oakland, California; Philip Strauss, Principal Attorney, San Francisco Department of Child Support Services, in San Francisco, California; Brady C. Williamson, Esquire, LaFollett, Godfrey and Kahn, former Chair of the National Bankruptcy Review Commission, from Madison, Wisconsin; Dean Sheaffer, Vice President and Director of Credit, Boscov's Department Stores, in Laureldale, Pennsylvania; Maria T. Vullo, Esquire, Paul, Weiss, Rifkind, Wharton and Garrison, out of New York City; Ken Beine, President of Shoreline Credit Union, of Two Rivers, Wisconsin; Dr. Robert Manning, Senior Research Fellow, Institute for Higher Education, Law, and Governance, University of Houston Law Center, in Houston; and Todd J. Zywicki, Esquire, George Mason University, Assistant Professor of Law.

We are sorry to have such tight seating arrangements. They are left over from yesterday's hearing. We had the CEOs of all the major airlines appearing before us, and apparently the coach seating kind of upset them just a little bit. [Laughter.]

Chairman HATCH. It has been left over for you today, so we hope it doesn't upset you as much as it did them.

We will begin with Judge Newsome and go on from there.

STATEMENT OF HON. RANDALL J. NEWSOME, JUDGE, UNITED STATES BANKRUPTCY COURT, NORTHERN DISTRICT OF CALIFORNIA, OAKLAND, CALIFORNIA

Judge NEWSOME. Good morning, Mr. Chairman and distinguished members of the committee. My name is Randall Newsome and I am a bankruptcy judge from the Northern District of California.

I should note at the outset that I am here representing only myself, no other person or organization. My intention this morning is not to make policy pronouncements or value judgments about bankruptcy reform. That is the role of Congress, not the courts. But I think my position as a bankruptcy judge puts me in a unique position to provide observations about how S. 220 will work as drafted.

My first observation is that the means test in this bill will move very, very few people from Chapter 7 to Chapter 13. As the data in my written testimony indicates, only about 15 percent of filers, if that, are above the median income, and probably no more than 3 percent will actually be forced into Chapter 13 or dismissed.

Senator BIDEN. What was that percentage, Judge? I am sorry.

Judge NEWSOME. Three percent.

Senator BIDEN. Three percent will be forced into 13?

Judge NEWSOME. Or dismissed.

Senator BIDEN. Or dismissed.

Judge NEWSOME. The problem for 97 percent of those who file will not be passing the test, it will be taking the test. By my count, the means test will require at least another five forms on top of what is already required. It will require the production of tax returns and a credit counseling certificate just to get in the courthouse door.

So even if you are like the 65-year-old single woman from Monticello, Illinois, I discuss in my written testimony making $657 a month in Social Security, or the cook from Decatur, Alabama, making $850 a month, or the single mother who draws Social Security and makes $1,170 per month as a temporary worker supporting three kids, you will have to get the credit counseling, file 16 or more forms—it might be 14—and dig out your tax returns for at least 1 year or more before you can perfect a filing in bankruptcy court.

The means test form alone will probably be several pages long. In any event, if you don't submit all the forms on time, your case will get dismissed automatically, no matter what the circumstances. And once you get dismissed, the bill makes it very hard to get back in and stay in. Thus, the overall effect of the bill is not to promote repayment of debts in bankruptcy; it is to try to keep people out of the system altogether.

By adding all of these forms and requirements to a simple Chapter 7 case and by imposing new requirements on bankruptcy attorneys themselves, the bill will make legal services too expensive for most consumer debtors to afford. They will be left trying to represent themselves or will turn to bankruptcy petition preparers, who frankly have become the bane of the bankruptcy system.

One thing it will not do is keep people from filing. If your income is about $21,500 a year, which is the median income of the bulk of the households in our case surveys, and your unsecured non-priority debts are about $23,400 a year, the median debt in our surveys, then bankruptcy is just about your only option.

Not only will the bill move virtually no one from Chapter 7 to 13, it largely destroys any incentive for debtors to file a voluntary Chapter 13, with the exception of those seeking to prevent foreclosure. At present, all Chapter 13 cases are voluntary. They comprise approximately 30 percent of all cases filed nationwide, and in some districts especially in the South, they amount to over 50 percent of the court's docket. Chapter 13 trustees pay out millions of dollars on unsecured debt every year. Much of that recovery for creditors may be lost under S. 220.

If these were the results intended by the drafters of the bill, so be it. The bankruptcy judge's job is to uphold the law as it is written and we will, or at least we will try. But these results are not what I understood bankruptcy reform to be all about when the process began several years ago.

Thank you for having me today.

[The prepared statement and attachments of Judge Newsome follow:]

STATEMENT OF HON. RANDALL J. NEWSOME, JUDGE, UNITED STATES BANKRUPTCY COURT, NORTHERN DISTRICT OF CALIFORNIA, OAKLAND, CALIFORNIA

Mr. Chairman and distinguished members of this committee, I very much appreciate the opportunity to comment upon the Bankruptcy Reform Act of 2001. By way of introduction, I have been a bankruptcy judge in the Oakland division of the Northern District of California since May of 1988. From October, 1982 until May, 1988 I was a bankruptcy judge in the Southern District of Ohio sitting in Cincinnati. From October of 1998 until October of 1999, I was the president of the National Conference of Bankruptcy Judges. However, I want to make it clear that I appear before you today representing myself only, not the NCBJ.

Before commenting on S. 220, it might be useful to provide some information about the people who are filing bankruptcies. One of the problems plaguing the debate over bankruptcy reform has been and continues to be the lack of empirical data. The anecdotes about bankrupt movie stars and rock musicians, as well as the catch phrases being bantered about, all make for, great speeches, but don't move us any closer to a real understanding of why over a million people filed for bankruptcy last year. In an attempt to help fill this empirical void, in 1999 60 bankruptcy judges from 33 different states surveyed 5235 randomly-selected cases that were closed in their districts within the previous year. That data was analyzed by Professor Gary Neustadter of Santa Clara University School of Law. Based upon his review of the 3151 cases filed and closed in 1998, he found (among other things) that the median gross income of debtors was $21,540, some $15,000 lower than the median income for all U.S. households in 1997. Only 15% of these debtors had gross annual income equal to or exceeding the national median income for families of the same size. The median amount of unsecured nonpriority debt for these same debtors was $23,411. A copy of Professor Neustadter's findings is attached as Exhibit 1.

I had my staff review all 5235 cases as to several other categories of information. The results of their review are attached as Exhibit 2. One of the most disturbing numbers concerns the level of medical debt reported. The average unweighted percentage of cases reporting over $1000 in medical debt was 25%. The medical debt numbers are probably understated, because they don't include medical debts that might have been charged to a credit card.

The data in the surveys also indicate that a small but significant number of debtors are either retired or disabled. It is very difficult to tell just how many people fall into these categories. Often debtors report receiving social security, but also state that they are employed, indicating that perhaps some of them are older people who can't get by without working.

One of the more interesting findings from these cases concerns the automobiles debtors own. The average model year of all cars and pick-ups reported in all 5235 cases was not quite 1989. In other words, the average debtor owns a car that is between 6 and 9 years old. Since the means test in § 102 of S. 220 allows a deduction from the debtor's income for monthly contractual payments to secured creditors, and since many debtors probably need a new car anyway, purchasing an automobile may become a legitimate form of pre-bankruptcy planning if the bill is enacted. That may be good news for the automobile industry, but bad news for auto lenders.

One number that I am unable to provide is how many of the debtors in these surveys would be dismissed or converted to chapter 13 under the means test. It seems there are as many ways to apply the test as there are people studying it. It's not just because some of the numbers seem to overlap. It's also because the IRS "Other Necessary Expenses" allowance appears to encompass anything that is reasonable and necessary for the health or welfare of the family or production of income. The alleged inconsistencies in applying the "substantial abuse" test presently incorporated into § 707(b) will seem trivial by comparison to what is wrought by the means test.

Notwithstanding these misgivings, I tend to agree with those who have speculated that very few debtors (probably less than 3%) will be dismissed or forced into chapter 13 by § 102.

If only 15% of all chapter 7 filers will trigger the means test, and only a handful of that group will be shuttled into chapter 13, why have the test at all? Putting aside the substantial burden this complicated construct will impose on the bankruptcy system, consider what every debtor, regardless of circumstance, will be required to do in order to obtain relief. I'll use a case from the Central District of Illinois. This case is fairly typical of what bankruptcy judges see virtually every day. The debtor is a 65-year-old retired single woman living in Monticello, Illinois, a small town about 40 miles from Decatur and 30 miles from Champaign. Her sole source of income is $657 per month in Social Security benefits. She also receives $10 a month in food stamps. Her monthly expenses total $827 per month, and are probably understated. She owns a 1987 mobile home and a 1993 Chevrolet Lumina. Both of these assets are exempted and unencumbered by debt. She lists $21,739 in unsecured debt on five credit cards and two department store cards. To characterize her as insolvent does not do her financial condition justice.

In order to be eligible for chapter 7 relief, she must first obtain credit counseling from an approved credit counselor within 180 days prior to filing, or if she has a good excuse, within 45 days after she files. She will then be required to file a certificate evidencing what credit counseling services she received, as well as any repayment plan developed.[1] Assuming she knows she has to obtain credit counseling, that the credit counselor must be on the approved list, and she is able to locate one, what are they going to talk about? She's 65 years old, she's got almost' $22,000 in debt, and she makes $657 per month. She needed credit counseling before she went $22,000 into debt, not when the money's already been spent. Why are we burdening her with credit counseling on the eve of bankruptcy?

For many of the debtors in our 5235 cases, credit counseling would simply be a pointless exercise. A case from South Dakota involving a husband and wife who both work and have three children is illustrative. Their mortgage balance is $12,801, and their payments are $118 per month. They budget $75 per month for clothes and $25 for recreation. They own a 1984 Isuzu and a 1988 Pontiac, and report owing money on one or both cars. They aren't in bankruptcy because of credit card debt—they don't have any. They apparently filed because of $67,373 in medical debts. With three dependents and a combined gross income of just over $2500 per month, it is unlikely that a credit counselor could do much for them. Nonetheless, S. 220 makes credit counseling a condition of eligibility for this couple, apparently on the presumption that their financial condition is the result of their profligate spending habits. This same presumption apparently applies to the single parent with three dependents in Lawrence, Kansas who makes $1170 a month as a temporary worker plus $341 in Social Security, has $249 in credit card debt but $10,900 in medical debt; and to the couple in Oxnard, California with one dependent whose only income is $1090 per month in SSI disability payments, who have no credit card debt, but report $5307 in medical debt; and to the cook in Decatur, Alabama who makes $850 per month and whose only unsecured debts are some $26,419 in medical debt. These cases are neither isolated nor anecdotal. There are many more just like them among the 5235 cases examined.

In addition to the credit counseling certificate and the extensive set of forms presently required, the retired woman from Monticello, Illinois and all other consumer debtors will need to file a means test calculation form,[2] an itemized statement of monthly income,[3] a statement disclosing any reasonably anticipated increase in income or expenditures over the next 12 months,[4] and a certificate of notice of alternatives under § 342.[5] Those who are employed will also be required to file pay stubs for the previous 60 days.[6] If the debtor fails to file all of these documents within 45 days of filing the petition, or within such additional time as the court allows up to another 45 days, then the case is dismissed automatically the day after the deadline expires.[7] If their case gets dismissed for failure to file any of these documents, and they try to file again within one year, they'd only be entitled to a 30-day automatic stay, which can only be extended if they rebut the presumption of bad faith the statute imposes.[8]

Debtors will also have to furnish the chapter 7 trustee with their most recent tax return by no later than the date first set for the meeting of creditors. All creditors are entitled to request copies of those returns. They may also request tax returns for the three years prior to filing and for returns that are filed postpetition and prior to the closing of the case.[9]

The stated intent of the consumer provisions of S. 220 was to shepherd those who could repay some of their debts from chapter 7 into chapter 13. But the effect of the provisions highlighted above and many others in the bill is to make it more difficult for anyone to obtain bankruptcy relief of any kind. Notwithstanding all of the hurdles and pitfalls, it is doubtful that many people will be deterred from filing. The financial condition of the overwhelming majority of debtors is such as to leave no other viable option.

Despite all of the problems in S. 220, there are many parts of this bill that would bring about welcome reforms. The provisions regarding collection of bankruptcy data, the permanent reenactment of chapter 12 and amendments to the preference statute to protect small trade creditors are representative examples.

Other provisions could be beneficial with some modification. Everyone agrees that instruction on personal financial management is sorely needed in this country. The financial management training test program in the bill is certainly a step in the

[1] S. 220, §§ 106(a); 106(d).
[2] S. 220, § 102(a)(2)(C).
[3] S. 220, § 315(b).
[4] Id.
[5] Id.
[6] Id.
[7] S. 220, § 316.
[8] S. 220, § 302.
[9] S. 220, § 315(b).

right direction. If the program were offered at no cost to debtors immediately after they attend their § 341 meeting, it probably would be far more effective than credit counseling obtained on the run to satisfy a bankruptcy eligibility requirement.

If the bill is to have a means test, it should be similar to the one proposed by Senator Grassley in the original Consumer Bankruptcy Reform Act of 1997. It should be enhanced by specific standards for determining bad faith and the need for specific findings by the court. The United States trustee should be assigned to enforce the test as one of her mandatory duties. Creditors and chapter 7 trustees should be permitted to bring motions to dismiss or convert in any case in which a debtor earns more than 125% of the median income for comparable households in the state.

If S. 220 must contain the means test as presently drafted, then debtors whose incomes are below the applicable median should be entirely insulated not only from its application, but from its paperwork requirements as well. All debtors should be required to file the schedules and statement of financial affairs presently prescribed by the Bankruptcy Rules in order to initiate their case. They should also be required to show the United States trustee their tax return for the previous year at or before the meeting of creditors. If the tax return and other evidence establish probable cause to believe that the debtor's income is above the median, then the debtor would be required to file all of the additional documents prescribed by the means test and by § 315 of the bill. If no such probable cause is found, then the debtor would be relieved of any further filing requirements.

This same two-tiered approach should apply to chapter 13 cases. As presently drafted, S. 220 destroys any incentive to file a voluntary chapter 13 case, unless the debtor is seeking to save his house from foreclosure. The enhanced discharge in chapter 13 has been eliminated,[10] as has the ability to alter the terms of secured automobile debts.[11] When these disincentives are combined with the continuing duty to turn over tax returns on a yearly basis and to fulfill other means test reporting requirements, the choice between chapter 7 and chapter 13 will be obvious to most debtors. If these provisions must be a part of S. 220, then they should only be applicable to those who were forced to convert their cases to chapter 13 pursuant to the means test. Voluntary chapter 13 filers who propose to pay back a substantial portion of their unsecured debt at a minimum should be given the ability to the modify their secured debts on motor vehicles purchased more than one year prior to filing. They also should be able to discharge debts that would be nondischargeable in a chapter 7 case under § 523(a)(2), (4) and (6).

One of the most glaring and widely-publicized abuses in the bankruptcy system is the ability of debtors in a few states to shelter most of their wealth through the use of an unlimited homestead exemption. Section 322 of the bill does not cure this problem. It would allow wealthy debtors to move to a state with an unlimited homestead, pour the bulk of their assets into a residence, and then hunker down for two years until they can file for bankruptcy. The two year provision should be eliminated, and a uniform $100,000 cap on homestead exemptions in bankruptcy should be imposed.

A much-needed and relatively uncontroversial suggestion for improving the bill would be to stop trying to regulate bankruptcy petition preparers, and simply ban them instead. They are subject to no standards of practice or conduct, they too often engage in the unauthorized practice of law and they frequently cause great harm to debtors and creditors alike.

These ideas for improving the bill are not fully formed, nor do they exhaust the list of suggestions. As always, I stand ready to assist this Committee in any way it deems appropriate in its pursuit of fair and workable bankruptcy reform. Thank you for this opportunity to appear and be heard.

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[10] S. 220, § 314(b).
[11] S. 220, § 306(b).

Exhibit 1

1998 Chapter 7 Cases	# Cases	% Sample	Median Gross Annual Income	cases gross annual income > national median income for same family size	% cases gross annual income > national median income for same family size	Median # All-Purpos Credit Cards	Median Debt All-Purpo Credit Cards	Median # Retailer/Gas Credit Cards	Median Debt Retailer/Gas Credit Cards	Median Unsecured NonPriority Debt
Total Sample (sum all districts reporting)	3151	100%	$21,540	475	15%	3	$8,500	1	$871	$23,411
Individual petition by unmarried person	1561	50%	$17,448	194	12%	3	$7,618	1	$517	$21,022
Joint petition by married persons	1054	33%	$30,720	227	21.50%	4	$10,785	2	$1,486	$28,818
Individual petition by married persons	536	17%	$20,382	54	10%	3	$6,695	1	$755	$21,881
Northern District of Alabama	158	100%	$20,436	12	7.50%	2	$5,348	1	$742	$19,103
Individual petition by unmarried person	68	43%	$17,402	5	7%	2	$3,626	1	$403	$16,308
Joint petition by married persons	58	37%	$28,650	5	9%	3	$3,519	2	$1,117	$21,899
Individual petition by married persons	32	20%	$18,248	2	6%	2	$4,716	1	$550	$16,960
Southern District of Alabama	42	100%	$15,070	3	7%	2	$2,330	1	$247	$17,878
Individual petition by unmarried person	14	33%	$12,946	1	7%	1.5	$3,561	0	$0	$10,600
Joint petition by married persons	15	36%	$22,608	0	0%	3	$712	1	$2,180	$25,225
Individual petition by married persons	13	31%	$9,828	2	15%	2	$2,291	1	$150	$17,569
District of Alaska	89	100%	$29,220	29	33%	3	$12,137	1	$1,831	$37,634
Individual petition by unmarried person	42	47%	$22,086	13	31%	2.5	$7,339	1	$879	$28,223
Joint petition by married persons	32	36%	$38,928	13	31%	5.5	$25,339	2	$3,640	$44,462
Individual petition by married persons	15	17%	$15,000	3	20$	3	$4,475	0	$0	$39,430
Central District of California	24	100%	$18,906	3	12.50%	4	$11,395	1	$784	$20,031
Individual petition by unmarried person	18	75%	$18,906	2	8%	4	$17,208	1	$784	$35,231
Joint petition by married persons	3	12.50%	$37,860	1	33%	3	$6,679	1	$80	$13,350
Individual petition by married persons	3	12.50%	$12,696	0	0%	1	$4,020	2	$1,646	$7,469
Eastern District of California	42	100%	$29,922	10	24%	4	$14,251	1	$589	$33,561
Individual petition by unmarried person	11	26%	$25,440	4	36%	4	$15,719	0	$0	$30,311
Joint petition by married persons	25	60%	$31,092	5	20%	4	$11,440	2	$1,708	$30,217
Individual petition by married persons	6	14%	$30,666	1	17%	6	$28,047	0	$0	$63,220
Northern District of California	50	100%	$30,102	21	42%	5.6	$25,628	1	$605	$37,310
Individual petition by unmarried person	31	62%	$25,800	14	45%	5	$26,038	1	$1,100	$37,469
Joint petition by married persons	14	26%	$39,984	7	50%	6.5	$23,880	1.5	$1,537	$34,423
Individual petition by married persons	5	10%	$30,000	0	0%	5	$22,391	2	$345	$50,000

1998 Chapter 7 Cases	# Cases	% Sample	Median Gross Annual Income	cases gross annual income > national median income for same family size	% cases gross annual income > national median income for same family size	Median # All-Purpos Credit Cards	Median Debt All-Purpo Credit Cards	Median # Retailer/Gas Credit Cards	Median Debt Retailer/Gas Credit Cards	Median Unsecured NonPriority Debt
Southern District of California	97	100%	$16,800	19	19.50%	3	$11,172	1	$2,006	$24,231
Individual petition by unmarried person	56	58%	$14,400	9	16%	3	$12,166	1	$958	$23,053
Joint petition by married persons	27	28%	$31,032	8	30%	4	$9,480	3	$2,803	$40,529
Individual petition by married persons	14	14%	$19,708	2	14%	3	$10,922	1	$370	$21,178
District of Colorado	97	100%	$21,888	15	15.50%	3	$9,206	1	$1,014	$27,769
Individual petition by unmarried person	53	55%	$19,332	5	9%	3	$9,093	1	$329	$26,757
Joint petition by married persons	27	28%	$30,756	8	30%	4	$12,015	3	$2,170	$31,178
Individual petition by married persons	17	17%	$22,800	2	12%	3	$6,526	1	$615	$28,955
District of Connecticut	39	100%	$36,240	13	33%	3	$8,296	2	$1,449	$30,100
Individual petition by unmarried person	18	46%	$26,090	6	33%	2.5	$6,119	1	$1,598	$30,340
Joint petition by married persons	17	44%	$38,184	6	15%	4	$11,908	2	$2,185.52	$28,866
Individual petition by married persons	4	10%	$29,701	1	25%	2	$6,408	2	$891	$47,071
Middle District of Florida	113	100%	$25,992	21	18.50%	5	$13,900	2	$1,601	$31,741
Individual petition by unmarried person	56	50%	$18,750	7	12.50%	4	$11,184	1	$583	$21,945
Joint petition by married persons	34	30%	$32,400	11	32%	4.5	$11,764	2.5	$2,844	$39,510
Individual petition by married persons	23	20%	$23,916	3	13%	3	$12,734	1	$731	$19,000
Northern District of Florida	5	100%	$14,544	0	0%	5	$11,040	2	$2,083	$22,203
Individual petition by unmarried person	4	80%	$13,680	0	0%	3.5	$6,562	2.5	$2,398	$20,016
Joint petition by married persons	1	20%	$42,181	0	0%	8	$40,742	1	$600	$52,517
Individual petition by married persons	0	0%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Middle District of Georgia	93	100%	$27,895	7	7.50%	2	$3,900	0	$0	$14,798
Individual petition by unmarried person	49	53%	$13,780	4	8%	2	$2,257	0	$0	$12,167
Joint petition by married persons	19	20%	$28,863	1	5%	3	$7,090	2	$977	$32,778
Individual petition by married persons	25	27%	$16,500	2	8%	2	$2,357	0	$0	$19,705
District of Hawaii	98	100%	$24,000	15	15%	3	$9,974	2	$2,466	$24,460
Individual petition by unmarried person	43	44%	$19,200	6	14%	3	$13,256	2	$2,155	$26,305
Joint petition by married persons	40	41%	$40,090	8	20%	3	$10,208	2	$2,895	$24,460
Individual petition by married persons	15	15%	$22,252	1	7%	2	$6,335	2	$2,393	$22,324

1998 Chapter 7 Cases	# Cases	% Sample	Median Gross Annual Income	cases gross annual income > national median income for same family size	% cases gross annual income > national median income for same family size	Median # All-Purpos Credit Cards	Median Debt All-Purpo Credit Cards	Median # Retailer/Gas Credit Cards	Median Debt Retailer/Gas Credit Cards	Median Unsecured NonPriority Debt
Central District of Illinois	113	100%	$20,448	8	7%	3	$6,242	2	$899	$22,900
Individual petition by unmarried person	53	47%	$13,920	4	7.50%	1	$3,019	0	$0	$14,929
Joint petition by married persons	48	42%	$22,860	3	6%	3	$6,673	2	$1,319	$24,832
Individual petition by married persons	12	11%	$23,976	1	8%	3	$6,067	1	$306	$23,792
District of Kansas	86	100%	$21,240	8	9%	2	$5,742	1	$504	$18,095
Individual petition by unmarried person	40	47%	$17,628	5	12.50%	2	$5,015	1	$426	$17,216
Joint petition by married persons	37	43%	$27,348	3	8%	3	$9,800	1	$538	$23,306
Individual petition by married persons	9	10%	$14,112	0	0%	1	$218	0	0	$16,757
Eastern District of Kentucky	42	100%	$16,657	2	5%	2	$6,800	1	$1,033	$20,044
Individual petition by unmarried person	18	42%	$15,366	1	6%	2	$68,960	1	$964	$18,6*2
Joint petition by married persons	16	38%	$24,492	1	6%	3	$12,524	1	$361	$21,762
Individual petition by married persons	8	10%	$13,722	0	0%	1	$5,226	1.5	$1,854	$16,109
Western District of Kentucky	64	100%	$16,986	0	0%	2	$2,170	1	$121	$14,162
Individual petition by unmarried person	37	58%	$14,556	0	0%	2	$2,256	0	$0	$13,968
Joint petition by married persons	21	33%	$19,392	0	0%	3	$508	1	$140	$15,722
Individual petition by married persons	6	9%	$22,518	0	0%	1.5	$5,513	1.5	$2,567	$14,304
Eastern District of Louisiana	58	100%	$14,448	4	7%	3	$4,648	2	$959	$21,683
Individual petition by unmarried person	32	55%	$14,130	0	0%	3	$4,281	2	$883	$21,552
Joint petition by married persons	17	29%	$30,276	4	24%	4	$9,507	1	$800	$32,748
Individual petition by married persons	9	15.50%	$13,752	0	0%	3	$3,836	2	$1,262	$14,988
Western District of Louisiana	83	100%	$18,240	4	5%	2	$6,657	2	$937	$21,102
Individual petition by unmarried person	42	51%	$15,030	3	7%	2	$6,596	1	$463	$13,995
Joint petition by married persons	32	39%	$25,218	1	3%	2	$8,620	3	$1,799	$27,310
Individual petition by married persons	9	11%	$12,984	0	0%	1	$618	2	$1,000	$12,708
District of Maryland	56	100%	$25,446	11	20%	3	$7,754	2	$1,710	$25,006
Individual petition by unmarried person	20	35%	$18,612	6	30%	3	$6,110	2	$1,913	$22,239
Joint petition by married persons	11	20%	$40,308	4	36%	4	$12,270	3	$2,505	$27,536
Individual petition by married persons	25	45%	$22,800	1	4%	2	$6,316	2	$1,043	$24,602

1998 Chapter 7 Cases	# Cases	% Sample	Median Gross Annual Income	cases gross annual income > national median income for same family size	% cases gross annual income > national median income for same family size	Median # All-Purpos Credit Cards	Median Debt All-Purpo Credit Cards	Median # Retailer/Gas Credit Cards	Median Debt Retailer/Gas Credit Cards	Median Unsecured NonPriority Debt
District of Massachusetts	70	100%	$24,000	11	16%	5	$16,277	2	$1,675	$27,288
Individual petition by unmarried person	32	46%	$18,231	4	12.50%	5	$15,235	1.5	$1,445	$26,058
Joint petition by married persons	21	30%	$28,968	5	24%	7	$25,931	3	$1,870	$33,175
Individual petition by married persons	17	24%	$28,596	2	12%	4	$13,000	3	$1,683	$25,200
District of Minnesota	28	100%	$19, 182	2	7%	4	$9,156	1.5	$291	$32,725
Individual petition by unmarried person	20	72%	$18,228	1	5%	3.5	$7,774	1	$288	$25,074
Joint petition by married persons	7	25%	$36,336	1	14%	4	$10,281	4	$1,872	$45,850
Individual petition by married persons	1	3%	$18,000	0	0%	6	$27,237	2	$6,001	$67,211
Eastern District of Missouri	287	100%	$22,176	47	16%	2	$5,094	1	$627	$19,410
Individual petition by unmarried person	159	55.50%	$18,192	22	14%	2	$4,398	1	$367	$15,921
Joint petition by married persons	82	28.50%	$34,350	21	26%	2	$6,610	2	$1,649	$28,647
Individual petition by married persons	46	16%	$21,816	4	9%	2	$4,880	1	$576	$17,429
District of Montana	20	100%	$22,146	0	0%	3.5	$13,374	1	$227	$34,366
Individual petition by unmarried person	8	40%	$15,828	0	0%	5	$22,252	1	$2,110	$34,366
Joint petition by married persons	9	45%	$30,348	0	0%	3	$6,417	0	$0	$44,320
Individual petition by married persons	3	15%	$12,804	0	0%	2	$12,450	1	$244	$29,452
District of New Jersey	36	100%	$22,440	7	19%	1	$3,618	1	$1,144	$22,257
Individual petition by unmarried person	18	50%	$14,674	2	11%	0.50	$817	1	$738	$15,601
Joint petition by married persons	9	25%	$33,369	3	33%	5	$14,439	3	$2,743	$34,223
Individual petition by married persons	9	25%	$23,040	2	22%	1	$1,400	1	$727	$21,109
District of New Mexico	5	100%	$15,324	0	0%	3	$13,955	2	$2,543	$24,016
Individual petition by unmarried person	3	60%	$12,155	0	0%	3	$13,955	2	$2,790	$24,016
Joint petition by married persons	1	20%	$29,886	0	0%	2	$2,051	2	$2,543	$16,087
Individual petition by married persons	1	20%	$24,629	0	0%	5	$26,415	0	$0	$33,316
Eastern District of New York	55	100%	$23,304	13	24%	5	$17,292	1	$1,386	$24,976
Individual petition by unmarried person	19	33%	$15,480	2	10.50%	5	$16,218	2	$2,234	$22,091
Joint petition by married persons	18	33%	$42,078	9	50%	5	$21,315	2	$1,693	$36,671
Individual petition by married persons	18	33%	$22,086	2	11%	4.5	$14,014	1	$767	$18,937

1998 Chapter 7 Cases	# Cases	% Sample	Median Gross Annual Income	cases gross annual income > national median income for same family size	% cases gross annual income > national median income for same family size	Median # All-Purpos Credit Cards	Median Debt All-Purpo Credit Cards	Median # Retailer/Gas Credit Cards	Median Debt Retailer/Gas Credit Cards	Median Unsecured NonPriority Debt
Southern District of New York	84	100%	$20,583	11	13%	4	$13,986	3	$4,059	$28,826
Individual petition by unmarried person	51	61%	$18,720	6	12%	4	$12,578	1	$3,850	$27,548
Joint petition by married persons	10	12%	$31,314	2	20%	6.5	$21,775	4	$6,350	$32,807
Individual petition by married persons	23	27%	$24,636	3	13%	12	$9,880	2	$4,582	$36,104
Middle District of North Carolina	53	100%	$19,284	5	9%	4	$17,950	1	$1,065	$34,375
Individual petition by unmarried person	29	55%	$14,544	2	7%	4	$17,482	1	$583	$26,632
Joint petition by married persons	14	26%	$30,702	3	21%	6.5	$23,439	3	$4,263	$48,292
Individual petition by married persons	10	19%	$17,460	0	0%	3.5	$10,671	0	%0	$43,451
Northern District of Ohio	12	100%	$25,332	2	17%	2.5	$3,797	1	$155	$13,182
Individual petition by unmarried person	6	50%	$25,332	1	17%	2.5	$7,379	1	$559	$12,697
Joint petition by married persons	4	33%	$34,200	1	25%	0.5	$332	0	$0	$28,252
Individual petition by married persons	2	17%	$8,028	0	0%	5	$7,691	3	$1,823	$9,869
District of Oregon	59	100%	$21,600	9	15%	3	$7,459	1	$578	$19,228
Individual petition by unmarried person	34	58%	$19,599	5	15%	2	$6,716	1	133	$18,938
Joint petition by married persons	21	36%	$34,080	3	14%	3	$8,400	2	$1,237	$19,690
Individual petition by married persons	4	6%	$27,738	1	25%	4.5	$27,278	1	$131	$44,588
Eastern District of Pennsylvania	66	100%	$26,640	16	24%	3	$10,543	1.5	$1,550	$29,470
Individual petition by unmarried person	24	36%	$23,618	5	21%	3	$6,845	1	$401	$21,852
Joint petition by married persons	24	36%	$37,050	8	33%	4.5	$12,397	2	$2,860	$32,460
Individual petition by married persons	18	27%	$24,480	3	17%	3	$11,631	2	$1,734	$29,710
Western District of Pennsylvania	83	100%	$18,119	15	18%	3	$8,817	2	$1,492	$21,561
Individual petition by unmarried person	41	49%	$17,808	6	15%	3	$9,835	1	$1,116	$20,172
Joint petition by married persons	34	41%	$23,993	8	24%	2	$6,458	3	$1,812	$25,293
Individual petition by married persons	8	10%	$12,504	1	12.50%	4	$17,942	1.5	$2,920	$28,875
District of Rhode Island	46	100%	$17,850	6	13%	4	$11,539	2	$2,675	$26,224
Individual petition by unmarried person	29	63%	$15,048	3	10%	4	$11,558	2	$2,750	$25,048
Joint petition by married persons	12	26%	$26,082	2	17%	3	$8,660	2.5	$2,747	$32,342
Individual petition by married persons	5	11%	$23,556	1	20%	3	$13,059	2	$1,178	$24,920

1998 Chapter 7 Cases	# Cases	% Sample	Median Gross Annual Income	cases gross annual income > national median income for same family size	% cases gross annual income > national median income for same family size	Median # All-Purpos Credit Cards	Median Debt All-Purpo Credit Cards	Median # Retailer/Gas Credit Cards	Median Debt Retailer/Gas Credit Cards	Median Unsecured NonPriority Debt
District of South Carolina	33	100%	$19,200	1	3%	4	$10,000	1	$588	$20,297
Individual petition by unmarried person	19	58%	$17,280	0	0%	4	$12,135	1	$330.89	$20,881
Joint petition by married persons	9	27%	$23,376	1	11%	4	$2,087	1	$26	$29,169
Individual petition by married persons	5	15%	$17,023	0	0%	2	$2,390	0	$0	$6,500
District of South Dakota	42	100%	$19,122	3	31%	3	$8,363	0.5	$27	$20,990
Individual petition by unmarried person	21	50%	$16,260	1	5%	2	$6,038	0	$0	$18,772
Joint petition by married persons	17	41%	$33,984	2	12%	4	$15,500	0	$0	$36,852
Individual petition by married persons	4	9.50%	$15,006	0	0%	0	0	1	$1,098	$17,960
Eastern District of Tennessee	75	100%	$16,560	6	8%	3	$4,673	1	$507	$19,510
Individual petition by unmarried person	35	47%	$14,820	2	6%	2	$4,128	1	$139	$18,325
Joint petition by married persons	29	39%	$20,100	3	10%	3	$6,288	2	$1,150	$22,134
Individual petition by married persons	11	15%	$21,288	1	9%	2	$2,982	1	$280	$31,069
Western District of Tennessee	176	100%	$20,568	23	13%	2	$3,756	1	$37	$19,237
Individual petition by unmarried person	81	46%	$17,832	8	10%	2	$3,106	0	$0	$17,442
Joint petition by married persons	53	30%	$32,676	10	19%	3	$9,412	1	$722	$26,493
Individual petition by married persons	42	24%	$18,400	5	12%	2	$2,930	1	$170	$15,758
Northern District of Texas	153	100%	$27,012	32	21%	5	$14,775	2	$1,400	$30,526
Individual petition by unmarried person	65	42%	$23,088	9	14%	5	$14,879	2	$1,430	$29,001
Joint petition by married persons	77	50%	$36,454	22	28.50%	5	$12,334	2	$1,395	$31,093
Individual petition by married persons	11	7%	$27,012	1	9%	6	$17,277	1	$975	$34,958
Southern District of Texas	104	100%	$29,966	35	34%	7	$22,187	2	$1,355	$34,831
Individual petition by unmarried person	40	38%	$23,116	10	25%	7	$19,870	2	$1,355	$31,784
Joint petition by married persons	49	47%	$42,240	23	47%	7	$22,295	2	$787	$40,044
Individual petition by married persons	15	15%	$25,920	2	13%	10	$26,136	2	$2,196	$32,954
Western District of Texas	54	100%	$21,600	6	11%	5	$16,164	2	$2,681	$28,531
Individual petition by unmarried person	22	41%	$15,340	4	18%	5	$13,628	2.5	$2,591	$28,180
Joint petition by married persons	24	44%	$25,249	2	8%	6	$20,720	2	$2,089	$35,684
Individual petition by married persons	8	15%	$20,457	0	0%	4	$12,855	2.5	$4,599	$22,876

1998 Chapter 7 Cases	# Cases	% Sample	Median Gross Annual Income	cases gross annual income > national median income for same family size	% cases gross annual income > national median income for same family size	Median # All-Purpos Credit Cards	Median Debt All-Purpo Credit Cards	Median # Retailer/Gas Credit Cards	Median Debt Retailer/Gas Credit Cards	Median Unsecured NonPriority Debt
District of Utah	67	100%	$21,228	9	13%	2	$3,112	0	$0	$22,157
Individual petition by unmarried person	37	55%	$19,200	5	13.50%	2	$3,507	0	$0	$18,474
Joint petition by married persons	19	28%	$24,960	2	18%	3	$4,218	1	$310	$24,700
Individual petition by married persons	11	16%	$22,589	2	18%	1	$192	0	$0	$20,456
Eastern District of Virginia	76	100%	$20,436	10	13%	2	$2,842	2	$963	$20,425
Individual petition by unmarried person	52	68%	$16,728	1	2%	2	$1,916	1.5	$746	$16,494
Joint petition by married persons	14	18%	$41,100	7	50%	5	$14,013	1.5	$1,113	$45,678
Individual petition by married persons	10	13%	$24,408	2	20%	2.5	$4,744	3	$3,068	$23,774
Eastern District of Washington	18	100%	$18,881	1	6%	2.5	$7,629	1	$672	$28,.123
Individual petition by unmarried person	11	61%	$17,448	0	0%	5	$29,700	1	$454	$29,700
Joint petition by married persons	3	17%	$19,572	0	0%	2	$1,087	3	$1,332	$21,028
Individual petition by married persons	4	22%	$25,487	1	25%	0.5	$1,600	1	$1,263	$33,070
National Medians for 1996										
U.S. Bureau of Census										
1 earner household (Table H-12)	$27,895									
Family of 2 (Table (F-8)	$36,072									
Family of 3 (Table F-8)	$44,108									
Family of 4 (Table F-8)	$51,518									
For each additonal family member, add $583										
Family of 5	$52,101									
Family of 6	$52,684									
Family of 7	$53,267									
Family of 8	$53,850									
Family of 9	$54,443									
Family of 10	$55,016									

Exhibit 2

DISTRICT, CITY (# of cases)	Car Age Average / Median	Number / Percentage of Cases with Medical Debts over $1000	Number / Percentage of Single Parents with Custody	Number of People Disabled or Retired	Number / Percent of Divorced Filers
N.D. Alabama, Decatur (100)	1988 / 1989	30 / 30%	9 / 9%	17	10 / 10%
N.D. Alabama, Anniston (97)	1989/1989	34 / 35.05%	7 / 7.22%	11	12 / 12.37%
S.D. Alabama, Mobile (99)	1990 / 1991	40 / 40.40%	13 / 13.13%	8	25 / 25.25%
D. Alaska, Anchorage (100)	1988 / 1989	28 / 28%	8 / 8%	10	18 / 18%
C.D. California, L.A. (100)	1988 / 1988	11 / 11%	7 / 7%	14	12 / 12%
C.D. California, Santa Barbara (100)	1988 / 1989	23 / 23%	22 / 22%	8	21 / 21%
E.D. California, Fresno (25)	1988 / 1990	6 / 24%	2 / 8%	1	1 / 4%
E.D. California, Sacramento (40)	1987 / 1989	8 / 20%	5 / 12.50	4	10 / 25%
N.D. California / Oakland (100)	1987 / 1989	10 / 10%	14 / 14%	15	16 / 16%
N.D. California / San Francisco (100)	1988 / 1988	11 / 11%	0 / 0%	9	10 / 10%

DISTRICT, CITY (# of cases)	Car Age Average / Median	Number / Percentage of Cases with Medical Debts over $1000	Number / Percentage of Single Parents with Custody	Number of People Disabled or Retired	Number / Percent of Divorced Filers
N.D. California, Santa Rosa (100)	1986 / 1988	9 / 9%	16 / 16%	7	17 / 17%
S.D. California, San Diego (99)	1990 / 1991	12 / 12.12%	8 / 8.08%	11	14 / 14.14%
D. Colorado, Denver (200)	1988 / 1989	37 / 18.50%	22 / 11%	20	35 / 17.5%
D. Connecticut, Hartford (76)	1988/1989	19 / 25%	7 / 9.21%	1	Marital status not provided
M.D. Florida, Orlando (100)	1991 / 1993	19 / 19%	12 / 12%	13	14 / 14%
N.D. Florida, Tallahassee (20)	1988/1989	6 / 30%	2 / 10%	1	7 / 35%
M.D. Florida, Tampa (101)	1990 / 1990	13 / 12.87%	9 / 8.91%	16	17 / 16.83%
M.D. Georgia, Columbus (99)	1989/1990	17 / 17.17%	10 / 10.1	15	18 / 18.18%
M.D. Georgia, Macon (100)	1989/ 1990	24 / 24%	24 / 24%	17	16 / 16%
D. Hawaii, Honolulu (100)	1989/1989	14 / 14.%	8 / 8%	9	16 / 16%

DISTRICT, CITY (# of cases)	Car Age Average / Median	Number / Percentage of Cases with Medical Debts over $1000	Number / Percentage of Single Parents with Custody	Number of People Disabled or Retired	Number / Percent of Divorced Filers
C.D. Illinois, Springfield (225)	1988/1989	77 / 34.22%	31 / 13.78%	15	23 / 10.22%
D. Kansas, Wichita (22)	1987/1988	12 / 55%	0 / 0%	5	4 / 18%
D. Kansas, Topeka (73)	1988 / 1989	22 / 30.14	8 / 10.96%	9	9 / 12.33%
E.D. Kentucky, Lexington (100)	1988 / 1989	34 / 34%	2 / 2%	12	10 / 10%
W.D. Kentucky, Louisville (92)	information not available	31 / 33.7%	7 / 7.61%	5	14 / 15.22%
E.D. Louisiana, New Orleans (98)	1991/1993	18 / 18.37%	13 / 13.27	8	15 / 15.31%
W.D.Louisiana, Alexandria (97)	1990 / 1991	20 / 20.62%	18 / 18.56%	8	23 / 23.71%
W.D.Louisiana, Opelousas (100)	1990 / 1991	34 / 34%	10 / 10%	13	25 / 25%
W.D.Louisiana, Shreveport (64)	1993 / 1994	17 / 26.56	11 / 17.19%	8	14 / 21.88%
D. Maryland, Greenbelt (96)	1989 / 1990	14 / 14.58%	18 / 18.75%	9	10 / 10.42%

DISTRICT, CITY (# of cases)	Car Age Average / Median	Number / Percentage of Cases with Medical Debts over $1000	Number / Percentage of Single Parents with Custody	Number of People Disabled or Retired	Number / Percent of Divorced Filers
D. Maryland, Baltimore (52)	1988 / 1990	6 / 11.54%	5 / 9.62%	6	6 / 11.54%
D. Massachusetts, Worcester (100)	1990 / 1990	11 / 11%	12 / 12%	12	10 / 10%
D. Minnesota, Minneapolis (89)	1987 / 1987	29 / 32.58%	8 / 8.99%	4	12 / 13.48%
E.D. Missouri, St. Louis (290)	1989/1990	82 / 28.28%	27 / 9.31%	13	58 / 20%
W.D. Missouri, Kansas City (96)	1988 / 1989	37 / 38.54%	9 / 9.38%	14	13 / 13.54%
D. Montana, Butte (50)	1985 / 1985	22 / 44%	7 / 14%	5	12 / 24%
D. Nevada, Las Vegas (96)	1990 / 1991	20 / 20.83%	15 / 15.63%	4	14 / 14.58%
D. New Jersey, Camden, Judge Wizmur (95)	1989 / 1990	31 / 32.63%	10 / 10.53%	4	14 / 14.74%
D. New Jersey, Camden, Judge Burns (23)	1990 /1988	3 / 13%	5 / 21.7%	0	3 / 13%
D. New Mexico, Albuquerque (25)	1986 / 1987	9 / 36%	1 / 4%	0	5 / 20%

DISTRICT, CITY (# of cases)	Car Age Average / Median	Number / Percentage of Cases with Medical Debts over $1000	Number / Percentage of Single Parents with Custody	Number of People Disabled or Retired	Number / Percent of Divorced Filers
E.D. New York, Westburg (20)	1988 / 1988	5 / 25%	0 / 0%	1	0 / 0%
E.D. New York, Brooklyn (70)	1989/1989	12 / 17.14%	13 / 18.57%	5	1 / 1.43%
S.D. New York, New York (100)	1990 / 1990	12 / 12%	14 / 14%	7	8 / 8%
M.D. North Carolina, Greensboro (100)	1990 / 1990	33 / 33%	10 / 10%	13	12 / 12%
N.D. Ohio, Toledo (100)	1989 / 1989	34 / 34%	14 / 14%	9	16 / 16%
N.D. Ohio, Cleveland (97)	1989 / 1989	28 / 28.87%	15 / 15.46%	13	17 / 17.53%
D. Oregon, Portland (125)	1987 /1990	31 / 24.80%	8 / 6.4%	12	9 / 7.2%
E.D. Pennsylvania, Philadelphia (100)	1989 / 1989	10 / 10%	21 / 21%	11	10 / 10%
W.D. Pennsylvania, Pittsburg (98)	1989 / 1989	15 / 15.31%	8 / 8.16%	9	7 / 7.14%
D. Rhode Island, Providence (50)	1985 / 1988	6 / 12%	9 / 18%	1	10 / 20%

DISTRICT, CITY (# of cases)	Car Age Average / Median	Number / Percentage of Cases with Medical Debts over $1000	Number / Percentage of Single Parents with Custody	Number of People Disabled or Retired	Number / Percent of Divorced Filers
D. South Carolina, Columbia (50)	1988 / 1989	15 / 30%	11 / 22%	2	0 / 0%
D. South Dakota, Pierre (102)	1986 / 1987	50 / 49.02%	17 / 16.67%	8	21 / 20.59
E.D. Tennessee, Greeneville (25)	1987 / 1988	11 / 44%	1 / 4%	4	6 / 24%
E.D. Tennessee, Chattanooga (84)	1989 / 1990	33 / 39.29%	14 / 16.67%	6	23 / 27.38%
E.D. Tennessee, Chattanooga (30)	1990 / 1994	8 / 27%	3 / 10%	3	Marital status not provided
E.D. Tennessee, Knoxville (25)	1990 / 1993	11 / 44%	4 / 16%	1	6 / 24%
M.D. Tennessee, Nashville (95)	1990 / 1991	39 / 41.05%	17 / 17.89%	7	14 / 14.74%
W.D. Tennessee, Memphis (400)	1991 / 1992	108 / 27%	47 / 11.75%	33	54 / 13.50%
N.D. Texas, Dallas (100)	1989 / 1991	16 / 16%	15 / 15%	Not reported	15 / 15%
N.D. Texas, Lubbock (100)	1989 / 1990	28 / 28%	10 / 10%	22	16 / 16%

DISTRICT, CITY (# of cases)	Car Age Average / Median	Number / Percentage of Cases with Medical Debts over $1000	Number / Percentage of Single Parents with Custody	Number of People Disabled or Retired	Number / Percent of Divorced Filers
W.D. Texas, San Antonio (97)	1990 /1992	12 / 12.37%	9 / 9.28%	4	7 / 7.22%
S.D. Texas, Houston (117)	1992 / 1993	22 / 18.8%	20 / 17.09%	6	0 / 0%
D. Utah, Salt Lake City (96)	1989 / 1991	36 / 37.5%	9 / 9.38%	5	24 / 25%
E.D. Virginia, Norfolk (100)	1990 / 1990	20 / 20%	22 / 22%	6	12 / 12%
E.D. Washington, Spokane (64)	1984 / 1987	18 / 28.13	11 / 17.19%	7	7 / 10.94%
AVERAGE OF PERCENTAGES		**25.51%**	**12.09%**		**15.24%**
AVERAGE CAR AGE	1988.92				

Senator SESSIONS [presiding]. Mr. Strauss?

Senator Hatch has stepped out. He will be back in a minute and he asked me to keep the panel moving.

STATEMENT OF PHILIP L. STRAUSS, PRINCIPAL ATTORNEY, SAN FRANCISCO DEPARTMENT OF CHILD SUPPORT SERVICES, SAN FRANCISCO, CALIFORNIA

Mr. STRAUSS. I am happy to move.

Mr. Chairman and Members of the Judiciary Committee, good morning. My name is Phil Strauss. I am the Principal Attorney of the Department of Child Support Services in San Francisco. I am authorized today to speak on behalf of the National Child Support Enforcement Association, the California District Attorneys Association, and the California Family Support Council.

Basically, my background is for the last 28 years I have been an employee of the Office of the District Attorney of the City and County of San Francisco, and for the last 25 years I have been with, as it was known at that time, the Family Support Bureau. That division is now an independent agency in San Francisco, known as the Department of Child Support Services.

For the last 13 years, I have been specializing in the enforcement of support during bankruptcy. I have practiced in this field, litigated numerous cases, handled numerous appeals. I write and teach on the issue, and I am here for the limited purpose of discussing the effect S. 220 will have on the ability of custodial parents to survive after the non-custodial parent has filed for bankruptcy protection.

I am very happy that this committee has invited me to speak today because it is important for you to understand the despair I see everyday when a bankruptcy petition stops child support debt in its tracks. I see far too many custodial parents, 95 percent or more of whom are women, in very difficult circumstances with little or nothing to cushion their fall when their child support or spousal support suddenly ceases.

I am the one who has to look them in the face and say there is just nothing I can do to get you the support which you need and are entitled to, at least in a timely fashion, after a parent has filed for bankruptcy protection. Much is needed to be done to protect this most vulnerable population, and these are basically moms who have custody of children.

Based upon my experience, I have proposed nine changes in the Code to ensure that support obligations would be paid during bankruptcy, and that they would be given significant preferential treatment. These proposals were originally introduced in the 105th Congress. They were polished and enhanced by other child support enforcement attorneys like myself in consultation with the National Association of Attorneys General. The culmination of that work is the child support provisions of the 106th Congress which are now in S. 220, Sections 211 through 217. Additional refinements were added in Sections 218 to 219.

The principles in drafting these provisions were six-fold. The provisions were intended to be largely self-executing, and the resulting benefit would be a reduction in the cost of litigation, better and more efficient use of court time and public resources, and the protection of custodial parents who would otherwise simply lose their support rights or sacrifice them by having to pay large attorney's fees which would in essence eat up whatever they could recover.

The provisions were intended to ensure that support payments would not be interrupted by the bankruptcy process. As members of the child support community, we wish to eliminate, or at least minimize the statutory conflicts between the Bankruptcy Code and the child support program.

The next principle is we wanted a clear recognition of the primacy of child support debts and that all generally recognized support debts would be entitled to special treatment under the code.

The fifth principle was the bankruptcy process should be structured so that the debtor would be able to liquidate non-dischargeable debt to the greatest extent possible within the context of the bankruptcy case and allow the debtor to emerge from the process with as fresh a start as possible.

Finally, the Code would assure that all support owing to a family would be paid first to the family before the government would receive any payments due to them for child support. Under current law, when a bankruptcy petition is filed, support frequently ceases. Debtors can emerge from the bankruptcy process with a discharge without paying their ongoing child support and liens securing the support debt can be lost. This loss may well doom any prospects for payment of the debt.

With that in mind, I drafted the provisions. I am here to answer any questions about the provisions, but you should know that really my expertise is in the field of viewing the Bankruptcy Code from the point of view of support creditors.

Senator Sessions. Thank you, Mr. Strauss.

[The prepared statement of Mr. Strauss follows:]

STATEMENT OF PHILIP L. STRAUSS, PRINCIPAL ATTORNEY, SAN FRANCISCO DEPARTMENT OF CHILD SUPPORT SERVICES

I welcome the opportunity to discuss the effect the "Bankruptcy Reform Act of 2001" will have on the collection of child support and alimony when a support debtor has filed a petition for relief under the Bankruptcy Code. For the past 28 years I have been employed as an attorney by the City and County of San Francisco, the last 25 of which have been spent establishing and enforcing support obligations in the Family Support Bureau of the Office of the District Attorney. At the end of last year the Bureau became the Department of Child Support Services, an independent county agency operated in compliance with the federal child support program under Title IV–D of the Social Security Act. For the last 13 years I have specialized in the collection of support during bankruptcy and have taught this subject to attorneys both in California and nationally. I have litigated bankruptcy support cases before the bankruptcy court, the district court, the Bankruptcy Appellate Panel, and the Ninth Circuit Court of Appeals.

Three years ago I drafted amendments to the Bankruptcy Code which were incorporated in bankruptcy reform legislation of the 105th and 106th Congresses. The language of those amendments was subsequently refined in a collaborative effort between myself and other child support attorneys in coordination with Karen Cordry of the National Association of Attorneys General. These amendments were adopted pretty must verbatim in the bankruptcy reform conference reports of the 105th and 106th Congresses and in the current bill, S. 220. It is my opinion, and the opinion of every professional support collector with whom I have discussed the issue, that the support amendments contained in Sections 211 through 219 of S. 220 will enhance substantially the enforcement of support obligations against debtors in bankruptcy. These enhancements will also result in a more efficient and economical use of attorney and court resources.

The support amendments have been endorsed by many individuals and organizations, including three national associations whose members consist of persons whose primary professional duty in the enforcement of support obligations in the federal child support enforcement program These organizations include: the National Child Support Enforcement Association, the National Association of Attorneys General, and the National District Attorneys Association. In giving my testimony on this issue, I am authorized to speak on behalf of the California District Attorneys .Association and the California Family Support Council. The membership of these organizations carries out the federal child support enforcement program in California.

During the past 13 years in which I have taught the subject of support enforcement during bankruptcy, I have appeared continuously in bankruptcy court, written a manual for support attorneys to use when dealing with bankruptcy cases filed by support debtors, counseled support attorneys in handling bankruptcy cases, and have reviewed virtually every court opinion written. on this subject since the enactment of the Bankruptcy code in 1978. Based on this experience, I developed what essentially became a "wish list" of amendments to the Bankruptcy Code aimed at facilitating support collection from bankruptcy debtors This wish list is reflected in sections 211–217 of S. 220. In this statement I will discuss not only how these amendments affect support debtors during bankruptcy, but what they mean in the larger context of support enforcement generally.

Before discussing specific sections, I would like to comment on the overall erect of these amendments. I believe they achieve the following: (1) a reduction in the need to appear in bankruptcy court and the consequential reduction in the cost of litigation; (2) a reduction in the current conflicts in law and policy between the Bankruptcy Code and the federal child support enforcement program [Social Security Act, Title IV–D]; (3) reasonable insurance that significant support enforcement mechanisms will not be interrupted by the bankruptcy process; and (4) a clear recognition of the policy that all generally recognized support debts are entitled to a preferential treatment in bankruptcy.

The most important amendment is found in section 214 which removes several significant collection remedies from the effect of the automatic stay Of these, the most valuable by far, is a provision allowing the continued operation of an earnings withholding order as defined in the Social Security Act. [42 U.S.C. 666(b)]. Since state courts or administrative agencies have already determined the appropriate level of support and arrearage payment, the removal of withholding orders from the reach of the stay will require a support debtor to design his or her bankruptcy plan to accommodate support debts—the most serious and primary of all financial obligations. Under current bankruptcy law the reverse is true. The support creditor is often forced to take a back seat to other ordinary creditors when a support arrearage is paid pursuant to a bankruptcy plan.

The importance of this amendment cannot be, underestimated. Federal law requires all support to be paid by employees through wage withholding orders. Such orders account for the lion's share of support collection receipts.[1] tinder current bankruptcy law, when a debtor files for protection under Chapters 12 or 13, the collection of ever. ongoing support is stayed. The economic detriment to a debtor's family, which is not receiving public assistance, can be devastating Surely sound public policy must recognize that there are some obligations which must be met, even when a debtor should be relieved from obligations to general debtors. Of these, none can be greater than the payment of support needed for the health and welfare of the debtor's family.

All too often a domestic court may reduce the current support order to accommodate the payment of arrears In such cases the total amount of payment through the assignment order may not only be helpful, but crucial, in providing for the daily needs of the debtor's spouse, former spouse, and children.

This amendment, therefore, not only insures that the payment of support by wage earners will not be interrupted. by bankruptcy, it will also avoid the need to entangle the debtor's family in the bankruptcy process. Under current bankruptcy law the support creditors would have to seek relief from the automatic stay in bankruptcy court in order to re-institute the earnings withholding order and file a claim to collect arrearage payments from the bankruptcy trustee. And even if these procedures were preformed by an attorney in the child support program, delays in support enforcement would be inevitable and the outcome unsure.

In addition to the removal of the earnings withholding process from the automatic stay, other federally mandated collection processes would be exempt under section 214 of the bill. These include the interception of the debtor's income tax refunds to pay support arrears: the license revocation procedures for those debtors who are not paying support; the continued enforcement of medical support obligations; and the continued reporting of support delinquencies to credit reporting agencies [2]

Perhaps the second most important and useful amendment to the Code is found in section 213 of the bill which prevents a debtor from obtaining confirmation of a bankruptcy plan and a subsequent discharge if that debtor has not made full payment of all support first becoming due after the petition date. This section is significant for two reasons. First it will prevent a support debtor from paying other debts at the expense of familial obligations. And second, this provision is self executing. Neither the support creditor, an attorney for the creditor, nor a public attorney will have to seek enforcement of this provision in bankruptcy court.

In addition this section allows a support creditor to seek dismissal of an ongoing plan at any time the debtor fails to pay the on-going support payment These provisions working together, provide crucial check points a three stages of the bankruptcy process. At the earlier confirmation stage, the support debtor will be reminded that payment of all important current support obligation is a critical step in getting approval of a bankruptcy plan as well as the lesson that payment of this obligation is essential to financial rehabilitation. It will set an example for the debtor early in the bankruptcy process. Further, since the goal of the debtor is to obtain a discharge of debt, this debtor will, at the outset of his case, understand that the failure to meet continuing support obligations will also doom the prospects of discharge at the end of the bankruptcy process. Finally, the creditor will have the option to seek a dismissal of the case during the process if the support debtor ceases to boner payment of on-going support obligations.

Section 211 of S. 220 provides a definition of support obligations. This definition is then incorporated in other areas of the Code The purpose of this definitional addition is to streamline the provisions of the Code dealing with support debts and to

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[1] According to the Committee on Ways and Means. U.S. House of Representatives, 1998 Green Book, p. 572, 56% of support collected in the last reported year (1996) was collected through the wage withholding process.

[2] In addition to the exclusion of enforcement remedies from the reach of the automatic, other family law issues are excluded from the stay, specifically (I) litigation of child custody and visitation issues, and (2) issues relating to domestic violence.

give all debts generally recognized as deriving from support obligations similar treatment in the Code. This provision will not necessarily change current law, but it will resolve many conflicting bankruptcy decisions which turn upon very technical interpretations of what a support debt is and what it might not be. Most significantly, highly arcane decisions concerning the dischargeability of such debts will be made moot and litigation over these issues minimized. Finally, support debts of all kinds will be subject to the same dischargeability, lien avoidance, and preference recovery rules

Under current law only a lien securing unassigned support is exempted from statutory lien avoidance procedures. With the new definition of support in section 211, all support obligations will be excepted from lien avoidance procedures. Not only will this change protect the tax payer when the debt is assigned to the government, it may also benefit the support creditor/parent who assigned the debt if the debt becomes unassigned under the new assignment rules established in the 1996 welfare reform legislation (the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 or PRWORAI. For example, under current bankruptcy law if a support debtor files a Chapter 7 case when his support obligation has been assigned to the government under the Social Security Act, the bankruptcy court may rule that a lien securing this debt impaired the debtor's homestead exemption and then void it. The debtor would then. be free to sell the property. If this property were the only known asset of the debtor, the debt would become uncollectible If tie support creditor then ceased receiving public assistance, that debt, now unassigned world likewise be uncollectible. However, under section 216 of S. 220, the lien would not be removed and the support debt would remain secured and thus collectible.

Under current bankruptcy law if the debtor pays support during the 90 day period prior to filing a bankruptcy petition, the bankruptcy trustee cannot recover this payment for the benefit of the bankruptcy estate unless the debt is assigned Under section 217 of S. 220 the trustee would not be able to recover any support paid by the support debtor during the preference period This rule significantly benefits the debtor because this debt is not dischargeable and would otherwise remain owing if recovered for the estate

No more significant statement of public policy has been made concerning the primacy of the payment of support debts than that found in section 212 of S. 220. Here the Code provides child support with the first priority for payment of unsecured claims. This section is divided into two sub-priorities so that distribution within the child support priority will go first to the family of the debtor, then to the government after the family has been paid, if the support has been assigned.

When these proposed amendments are considered, it is not difficult to see why support enforcement professionals so strongly endorse them and are so thankful to the sponsors of this legislation for their inclusion. Many of these amendments literally remove bankruptcy as an obstacle to support enforcement, and they do so in a self-executing manner. Consequently, no claims or stay litigation is required to continue the collection of a support debt when an earnings withholding order is feasible; no confirmation litigation is be needed when the debtor is not paying a postpetition preconfirmation support order; and no dismissal or stay relief litigation would be required to insure postpetition support was paid before a discharge could be granted.

Avoiding bankruptcy court is important to support creditors and their attorneys. Even when a support creditor is financially able to hire a bankruptcy attorney, litigation of support issues in bankruptcy is likely to eat up large chunks of recoverable support. Most support creditors would be totally lost if required to navigate through the complex set of rules and procedures to seek relief in bankruptcy court without counsel And government support attorneys are generally ill equipped to litigate bankruptcy issues and do not have the luxury of referring the case to bankruptcy specialists. After all, it should be remembered that the law of bankruptcy is a speciality with its own bar, judges, code, rules, procedures and, indeed, its own language.

Some criticism has been raised that bankruptcy reform would be detrimental to women and children because it would pit them against banks and credit card companies for collection of nondischarged credit card debt. Although this argument has some surface logic, no support collection professional that I know believes this concern to be serious. Of course, if support and credit card creditors were playing on a level field, banks with superior resources might have an advantage However, nonbankruptcy law has so tilted the field in favor of support creditors that competition with financial institutions for the collection of post-discharge debts presents no problems for support collectors.

In the first place the ubiquitous earnings withholding process for support collection absolutely trumps any financial institution's attempt to collect this debt from the debtor's wages or salary since withholding orders have priority, no matter when issued or served. In most cases if the support collection was 25% or more of the debtor's wages, the Consumer Credit Protection Act would lock out the financial institution from collection of its debt from the debtor's wages. Thus, with respect to creditors of wage earners, there is no conceivable way that the existence of postpetition credit card debt, dischargeable under current law, would adversely affect the collection of support.

Even when the debtor is not a wage earner, support creditors have numerous and highly significant advantages over other creditors While this list is certainly not exhaustive, support creditors have the following remedies not possessed by other creditors, and certainly not credit card or other financial creditors: (a) support debts are already reduced to judgments and have the advantages of court process to collect judgments; (b) tax intercept collection; (c) interception of unemployment benefits/worker compensation benefits; (d) free or low cost collection services by the government; (e) license revocation for nonpayment of support; (t) free or low cost interstate collection, including interstate wage withholding and interstate real property liens; (g) criminal prosecution or contempt actions; (h) no avoidance of liens securing the support debt; (i) federal collection and prosecution for support debts; (j) denial of passports; (k) collection from otherwise protected sources: ERISA plans, trusts, and federal remuneration

To say that these advantageous remedies will necessarily result in the collection of support is not possible. Many support debtors are actually quite skillful evaders of support obligations. These same people will probably be just as adept at avoiding collectors from financial institutions. The point to be made, however, is not that support debts will necessarily be collected after bankruptcy, but that the collection of support debt is in no way hampered simply because credit card debt has survived bankruptcy and financial institutions are going to attempt to collect it.

Some have argued that after bankruptcy a support debtor will be inclined to pay credit card debt to retain a credit card and not pay support Of course, this argument assumes that after bankruptcy the debtor wilt find an institution willing to extend credit Even if one did, it seems unlikely that retention of a credit card would be more important than retention of a driver's license, staying out of jail, or keeping a passport.

The bottom line as I see it in analyzing S. 220 with respect to its effect on the collection of support is to note that the advantages explicit in the bill far outweigh any speculative concerns that some debtors might not pay support if they are left with credit card debt after bankruptcy What concerns support collection professionals the most in carrying out their duties is not competition with financial institutions outside bankruptcy, but competition with other general creditors, including financial institutions, during bankruptcy. S. 220 readjusts the relative strength of support creditors during the bankruptcy process, giving them meaningful, even crucial, assistance The support provisions of this bill certainly justify the praise given them by virtually all of the national public child support collection organizations in this country.

SUMMARY

The support amendments contained in Sections 211 through 219 of S. 220 will enhance substantially the enforcement of support obligations against debtors in bankruptcy. The overall effect of these amendments will achieve the following: a reduction in the need to appear in bankruptcy court and the consequential reduction in the cost of litigation; a reduction in the current conflicts in law and policy between the Bankruptcy Code and the federal child support enforcement program, reasonable insurance that significant support enforcement mechanisms will not be interrupted by the bankruptcy process; and a clear recognition of the policy that all generally recognized support debts are entitled to a preferential treatment in bankruptcy.

This bill allows the continued operation of an earnings withholding order, thus insuring that the payment of support by wage earners will not be interrupted by bankruptcy. Other federally mandated collection processes would also be exempt.

The bill prevents a debtor from obtaining confirmation of a bankruptcy plan and a subsequent discharge if that debtor stops payment of support. It provides a comprehensive definition of support and treats such a debt preferentially throughout the code, including giving such a dept the first priority in payment.

The support provisions of this bill certainly justify the praise given them by virtually all of the national public child support collection organizations in this country. It streamlines the bankruptcy process for support creditors by removing the need for their participation in it.

Senator SESSIONS. Mr. Williamson is an attorney in Madison, Wisconsin, and former Chair of the Bankruptcy Review Commission.

Mr. Williamson?

STATEMENT OF BRADY C. WILLIAMSON, LAFOLLETT, GODFREY AND KAHN, AND FORMER CHAIR, NATIONAL BANKRUPTCY REVIEW COMMISSION, MADISON, WISCONSIN

Mr. WILLIAMSON. Thank you, Mr. Chairman. Among other things, I am an appellate lawyer and I don't make it a practice to disagree with court of appeals judges, at least publicly, but I think it is necessary here, if I might start with a few seconds responding to Judge Becker.

The National Bankruptcy Review Commission unanimously recommended the elimination of the two-tiered bankruptcy appellate system, and that recommendation is embodied in Section 1215 of the pending legislation. Section 1215 will save time, it will save an extraordinary amount of money in legal fees and costs, and it will improve the development of a law, because right now a bankruptcy court has no precedential influence beyond its own courtroom. A district court has no precedential influence beyond its own courtroom. So we have literally thousands and thousands of bankruptcy appeals that only matter to the parties, that do not help develop the law.

While this provision would have a short-term impact on the caseload in the court of appeals, it would have a salutary impact on the court caseload in the district courts which are dealing everyday with drug cases and major civil litigation. This is a provision in the bill that should be adopted, has been adopted by the Congress, and I can't recommend it more forcefully.

Judge Becker did make a point I want to agree with, and that is that an appeal to the U.S. Court of Appeals, at least for a practicing lawyer, is a little bit more formidable than an appeal to a district court judge. It does take more time, it does take more effort. Because of that, I think we will see fewer appeals. Litigants in bankruptcy cases will be less likely to appeal directly to the U.S. Court of Appeals than they will be to the district court. The single most important reason for this change is that it will improve the jurisprudential chaos that now rules in the bankruptcy courts.

Now, on a broader point, this will be the fourth time in a hundred years that this Congress has undertaken major bankruptcy legislation—1898; 1938, in the wake of the Depression; and, of course, 1978. Yet, this legislation may have a more comprehensive effect, a more dramatic effect on consumer bankruptcies and on business bankruptcies, which is the focus of my testimony this morning, than those previous Congressional efforts to improve the bankruptcy system.

There is relatively little doubt that bankruptcy legislation will be adopted by both Houses and that it will be signed into law. And it is that likelihood that leads me to urge this committee to review very carefully the changes that are being proposed, not to stop the bill, but to ensure that it reflects economic reality and that it actually accomplishes the goals its proponents espouse.

Senator BIDEN. Brady, have you forgotten about Senator Kennedy?

Mr. WILLIAMSON. I have not forgotten about Senator Kennedy. In fact, I spoke about this very matter with Senator Kennedy in Eau Claire, Wisconsin, not long ago.

Senator BIDEN. I am sure you did.

Mr. WILLIAMSON. But it is precisely, Senator Biden, because this legislation may well be headed for enactment that it really requires this committee's careful attention. This legislation is not ready for the floor, and it is not ready for two overarching reasons.

One is the economy is literally changing around us. This morning's Washington Post: "Verizon Lays Off 10,000 People." Saturday's Milwaukee Journal Sentinel: "Record Layoffs Hit State." In December alone, more than 140 businesses in Wisconsin laid off 50 or more employees. That is the fifth highest in the country. Whatever the theoretical economists may tell us about what is happening in the economy, these layoffs are a harsh financial reality for American families, and for many they will be a disaster.

But there is also grave concern about the effect of the economy and this legislation on small business layoffs and the small business bankruptcies that may follow. We all know about the major bankruptcies that have occurred just in the last 30 days—a major airline. Health care insolvencies are increasing rapidly. In Senator Feinstein's State, we have had utilities threaten to file for bankruptcy.

All of this makes a critical point. The legislation about which Senator Hatch spoke at the outset, how it passed the Congress in 1998 and last session, that happened at a time when we were hitting our economic prosperity. But times have changed, and that requires this committee to look more carefully, as President Bush suggested, at this legislation.

Let me focus very quickly, Mr. Chairman, since I began with—

Senator SESSIONS. This is not the court of appeals. You don't disappear into a pit if you go over the light, but we do try to follow the light as much as possible.

Mr. WILLIAMSON. Thank you. They do tell the story about the Chief Justice of the United States cutting off a lawyer in the middle of the word "is" when his time was up.

Senator BIDEN. Wasn't there another guy who had trouble with that word?

[Laughter.]

Senator BIDEN. That seems to be a complicated word.

Mr. WILLIAMSON. You know, Senator Biden, as that anecdote escaped my lips, I did suspect somebody might make a reference to it.

Senator BIDEN. I just wondered.

Mr. WILLIAMSON. The bill covers more than 300 pages. It has almost 200 sections. With respect to its impact on small business and business generally, I want to point out three particular provisions that have not gotten a great deal of attention—Section 912 dealing with asset-based securitization, Section 708 which gives creditors the ability to argue that a corporation's obligations to them are not dischargeable.

Now, this notion of non-dischargeability is common in consumer bankruptcy, but it introduces a major new element into business bankruptcy that will permit a single creditor—we are talking about corporate bankruptcy—to allege that the debtor corporation has issued false and misleading financial statements, and thereby in effect to stop the bankruptcy, to stop the reorganization. So this concept of non-dischargeability in corporate bankruptcies ought to receive serious examination by the committee.

Now, you can imagine what impact this would have on a small plastics company that employed 50 people in Mobile, Alabama. But imagine what this provision might do to a major reorganization, especially in an industry that produces a product or a service that is not quite so mundane as plastics—tobacco, firearms, HMOs, and in California utilities.

Senator SESSIONS. Mr. Williamson, I appreciate your comments and I know, serving on the commission, you have a lot of insight. We will make that a part of the record. If you have any other things you would like to add to it, what you have already said, we would be glad to hear it. However, in the interest of time, it would be good if you could wrap up shortly.

Mr. WILLIAMSON. I do, Mr. Chairman, and I will do it on an issue that I know that you agree with me on, and that is the need for this legislation to contain the original Sessions-Kohl amendment. That amendment, of course, eliminates one of the grossest abuses in bankruptcy law, which is the unlimited homestead exemption. It passed this body 76–22, with bipartisan support.

There has been widely reported in the media another example of a citizen in the State of Florida using the unlimited homestead exemption to cheat his creditors. The bankruptcy law in this country in many ways represents our values, and it cannot be one of our values that people who are able to use $3 million homes are able to cheat their creditors.

Thank you, Mr. Chairman.

Senator SESSIONS. Thank you very much, and I share that view. It is not far from Mobile to Pensacola. It is a shame that you can simply sell your house in Mobile and buy one only 50 miles away in Pensacola without having to give that house up after filing for bankruptcy.

Mr. WILLIAMSON. Although I don't know why, Mr. Chairman, anyone would want to move from Mobile to Pensacola.

Senator SESSIONS. I do not either.

[Laughter.]

Senator FEINSTEIN. Mr. Chairman, he said three sections, but he only named two, 912 and 708. What is the third one?

Mr. WILLIAMSON. Senator, the third would be the sections dealing with small business bankruptcies. There are a package of proposals to accelerate the process for small business bankruptcies. The difficulty with it, I think, is that the definition of a small business bankruptcy is a corporation that has less than $3 million in liabilities. And in some States—Alabama, probably not Delaware or California, but Wisconsin for certain—that would be 90 percent of all bankruptcies. So it is not that we are doing a special provision for smaller bankruptcies. In most States, we are doing a provision that is going to affect all bankruptcies.

Senator SESSIONS. As you know, on the homestead we did make progress with this legislation. We were up against a number of States whose constitutional provisions were being overridden by this legislation and Senators from those States were quite tenacious in protecting their State's law. It was not an easy task, but in spite of those Senators' tenacity we were able to craft this much-improved alternative.

[The prepared statement of Mr. Williamson follows:]

STATEMENT OF BRADY C. WILLIAMSON, LAFOLLETT, GODFREY AND KAHN, AND FORMER CHAIR, NATIONAL BANKRUPTCY REVIEW COMMISSION, MADISON, WISCONSIN

Three times in the last 100 years, Congress has passed major legislation exercising its Constitutional responsibility to adopt "uniform" laws of bankruptcy. The Bankruptcy Act of 1898 gave the country its first comprehensive system. The Chandler Act of 1938, adopted in the wake of the Depression, gave American families the choice they still have today—between liquidation in Chapter 7 and a multi-year repayment plan in Chapter 13. And, of course, the legislation adopted in 1978 recreated the bankruptcy code that (amended in 1984 and 1994) today protects creditors and consumer and business debtors.

The legislation pending before the Senate Judiciary Committee is no less comprehensive than the three major "reforms" of the last century—indeed, in many ways, it is more comprehensive. And it will be more dramatic in its impact on creditors, on consumers with unbearable debt, and on failing corporations. This legislation, in different forms, passed both the Senate and the House in 1998 but failed when there was no agreement on a conference report. This legislation, as a conference report, passed both the Senate and the House last year but failed when the President declined to sign it. Now, it is again before the Congress: S. 220 here and H.R. 333 in the other body.

There already have been hearings, the bill's proponents maintain, and the Congress already has expressed bipartisan support for the legislation. With a new President, they contend, the bill is "ready" for final passage.

It is not.

There is relatively little doubt that new bankruptcy legislation will be enacted this year. Yet the legislation before the Committee should not be sent to the floor of the Senate, let alone adopted there wholesale, without significant improvements. In fact, the likelihood that the bankruptcy law will be changed this year should lead the Committee to review very carefully the pending legislation—not to stop it, but to ensure that it reflects economic reality and that the bill actually accomplishes the goals its proponents espouse.

The bill is not "ready" for two overarching reasons. First, the significant changes occurring today in the American economy are not reflected in the bill. Second, notwithstanding the previous consideration of the bill, it carries provisions that are self-defeating and, in particular, the business bankruptcy sections of the legislation will have significant consequences that have not received the attention they deserve. Some of the most troubling provisions were added to the bill late last year without the benefit of any consideration at all in either body.

ECONOMIC CHANGE

Last Saturday, the *Milwaukee Journal Sentinel* carried this headline: "Record layoffs hit state." In December alone, more than 140 state businesses laid off 50 or more employees, the fifth highest in the country. There no doubt have been similar news stories in Utah and Vermont and New York and many other states because the dramatic increase in layoffs is a national trend.

Even with relatively high employment, businesses are laying off American workers in record numbers. Most find jobs elsewhere—although often only after a period of no income—frequently at lower wages and benefits. Bankruptcy has become a pace to stop for those on their way down the economic ladder who want to climb back. Two-thirds of the debtors is bankruptcy report a significant period of unemployment preceding their filings. For single-parent households, even a short period of unemployment can be devastating. Married couples fare slightly better, but they do not escape employment problems: more than half of the married couples in bankruptcy reported both the husband and the wife unemployed preceding the bankruptcy filing.

Whatever the theoretical economists may conclude, the harsh reality of these layoffs means financial disaster for some American families. Given the falling national savings rate and the thin financial margin familiar to many families, the result surely will be more consumer bankruptcies.

There is also a harsh reality in these statistics for American business. The layoffs at AOL Time Warner, Lucent Technologies, DaimlerChrysler, General Electric and other major companies add up, *The Chicago Tribune* has just reported, to a "corporate carnage" that is overwhelming. Yet small business layoffs have a far greater cumulative effect on the economy, and these less-publicized layoffs may well precede a sharp rise in small business bankruptcies. Unlike consumer bankruptcies, which have decreased for months, business bankruptcies have been increasing, and they will only continue to increase.

While the bankruptcy courts are flooded with laid off workers, the entrepreneur who has struggled to run a small business is also at grave risk. Creditors will not lend to small businesses without the personal guarantee of the owners. The legal structure that protects large corporations offers no debt relief for the owner of a failing small business. Small business owners are three times more likely to file for bankruptcy than their wage-earning counterparts.

Business bankruptcies is some areas—steel and heavy manufacturing, the motion picture theater industry, and the dot-coms so vibrant in the past—already have reached alarming levels. Another major airline just filed for Chapter 11. Sunbeam went into Chapter 11 this week. Health care insolvencies, particularly failing HMOs, continue to increase and, while the pending legislation addresses limited aspects of that trend in the health care industry, it does not address more fundamental questions—whether federal or state law has precedence, for example. Nor does it address the loss of health care coverage for consumers already pushed to their financial limit.

And all of this makes this critical first point. This legislation was largely drafted at a time when this country's economy was at the height of its prosperity—when business and consumer bankruptcies were decreasing. That prosperity was the prism through which the Congress and legislation requires thoughtful analysis in today's light.

President Bush, in an interview on Monday, expressed that very concern. The *Milwaukee Journal Sentinel* reporter who took part in that interview quoted his complete response to a question about the national debt:

"It's important to pay down the debt at the federal level," Bush said. "No question about it, and our plan does that. The debt I'm most concerned about, however, is the consumer debt, credit care debt, the debt that burdens thousands of Americans. And we'd better be really careful about not recognizing the combination of an economic slowdown, high energy prices and debt overhand—what that means to working people."

The President said that it was time to be "really careful," and so it is with this legislation.

Nowehere, perhaps, is the light of today's economy colder or harsher than in California, where about one of every ten consumer bankruptcies in this country are filed. There, a new problem has arisen: major utilities already have threatened to file for bankruptcy—leaving the state and its ratepayers and the financial institutions with millions of dollars at risk all potential parties in a single bankruptcy proceeding before a single federal judge.

Has anyone (besides the legal counsel for the utilities and their creditors) closely reviewed the bankruptcy code to determine the effect a utility filing might have? Has anyone (including the legal counsel for the utilities and their creditors) closely reviewed this legislation to determine it effect on a utility filing? Everyone has a stake in these questions, including the pension funds and their members heavily invested in utility stock.

Five years ago, the U.S. Supreme Court in *Seminole Tribe of Florida* v. *Florida*, 517 U.S. 44 (1996), applied the Eleventh Amendment in a case about the regulation of gambling that has had significant repercussions in bankruptcies where state and local government are often creditors and claimants. If a major utility fails and files for bankruptcy, whether in California or in any other state, the tension between federal authority and state autonomy inherent in the Constitution will have to be resolved in very difficult circumstances.

Over the last two years, the Congressional debate on this legislation has focused on its consumer provisions—the means test, for example, and the expanded priority status the bill affords some credit card debt. That attention was, and it remains, warranted, but the debate has obscured the sweeping effect of the legislation's Chapter 11 proposals. And those proposals need the same kind of vigorous debate that has characterized the consumer provisions.

In yet another development, not reflected in the legislation, the new Study on Financial Privacy and Bankruptcy requires prompt consideration. Its recommendations should be considered as part of this legislation to balance the important privacy interest of individual families and businesses using the bankruptcy system with the public interest in the open and efficient administration of that system. The bankruptcy process necessarily involves "private" financial information, and there can be abuse both in disclosing the information needlessly and in subject it to confidentiality too readily.

LEGISLATIVE PROBLEMS

Too much has happened since the bill was drafted to rush it to the floor of the Senate, especially at the beginning of a new Congress and especially with the country's economic direction uncertain. So, even if the legislation before the Committee were flawless, it still would require the attention of the Committee's members and staff. But the bill is far from flawless.

Parts of the bill were drafted in haste in the closing days of the last session. Parts of the bill were not even considered by the Senate, let alone by this Committee, and parts of the bill stand in sharp contrast to the expressed will of the Senate. (This is not the bill that the Senate initially adopted last year.) While all of that may be understandable, it should not bind this Committee or the Senate to adopt the legislation unchanged. Many of the bill's problems arise not from what the drafters or the proponents intended but from the unintended consequences of those intentions.

The bill covers more than 250 pages and has almost 200 sections. While there are more examples, three sufficiently illustrate the point that the bill requires additional consideration to prevent it from having harsh or unintended consequences.

The bill section 912 declares that assets transferred as part of an "asset based securitization," including accounts receivable, no longer will be property of the estate as defined in 11 U.S.C. § 541. That means these assets no longer will be available to help the corporate debtor reorganize. This provisions has not been fully explored, yet it may well prove a significant obstacle to successful corporate reorganizations that will save jobs.

Section 708 gives creditors the ability to argue that a corporation's obligations to them are non-dischargeable. While this concept, non-dischargeability, is common in consumer bankruptcy, it has not been part of the bankruptcy code since 1978. And for good reason. The old law permitted a single creditor to disrupt a corporate reorganization at the expense of other creditors. Indeed, a single creditor could prevent what almost everyone else desires: a reorganization that treats all creditors fairly and permits the corporation to reorganize for the benefit of all of its creditors, customers and employees.

If the legislation becomes law, a single creditor can stop a potentially successful reorganization with the charge that a corporation deliberately made materially false financial statements. Whether or not the allegation can be provide, there organization process will slow to the point that it becomes impractical if not impossible for the corporation to reorganize. Creditors no longer will be united in interest nor dedicated to a reorganization that treats all of them fairly. Smaller businesses will be particularly susceptible to this kind of tactic but, just for the moment, consider it repercussions not on a plastics company employing 50 workers but on a company employing thousands of workers with a less mundane product or service—tobacco products, for example, or firearms or, more recently HMO's and utilities.

There is no evidence that the provisions was added, late in the legislative process, to address a particular problem or to affect a particular industry. Indeed, there is no public evidence at all of the provision's genesis. The potential impact of this single provisions is enormous, however, and undeniable. Moreover, it collides with the provisions of the bill designed to more business bankruptcies through the judicial system more quickly. And those provisions, too, require additional attention from this Committee.

The proposal provides accelerated deadlines for the "small business debtor" in bankruptcy, and this is the third—and, perhaps, best—example of the law of unintended consequences. In addition to its mandate for speed and new reporting requirements, these provisions require that the corporate debtor show within six months that, more likely than not, the court will confirm a plan of reorganization within a reasonable period of time. Many aspects of this part of the bill reflect current judicial scheduling practices. Yet the new requirements will have a dramatic impact on the number of successful reorganizations and, of no less significance, on the number of successful creditor-debtor negotiations that lead to successful reorganizations or orderly liquidations.

The collective impact of these provisions, moreover, regardless of their individual merit, warrants reconsideration in light of their virtually universal application. The proposal defines the "small business debtor" as any business with less than $3 million in liabilities. In some states, that will include every Chapter 11 filed. Especially in light of current economic conditions, the Committee should ask whether the inflexibility in the proposed statutory deadlines for "small business debtors" makes sense. Four out of every five corporations that face a potential Chapter 11 today might well be subject to these "special" provisions.

For these reasons, and others, the legislation has drawn opposition from creditor groups like the Commercial Law League and businesses concerned about its practical impact. The National Bankruptcy Conference, perhaps the pre-eminent independent group in the bankruptcy field, has reviewed last year's conference report and just released its analysis. Provision by provision, the NBC's report reviews the areas where the legislation makes good sense and, in contrast, the areas where it conflicts with itself or promises consequences neither desired nor imagined by its proponents.

The Committee already has heard testimony about the need for careful consideration of this bill—both in light of changing economic conditions and the consequences, unintended in some instances, of the proposal. There is another reason the Committee needs to place its mark on the proposal: it ignores, in some key respects, the expressed wishes of the Senate. Important provisions adopted by the Senate have disappeared without a trace. There are several examples, but I'll conclude with just one.

On November 10, 1999, the Senate by an overwhelming vote of 76 to 22 adopted the Kohl-Sessions amendment limiting the homestead exemption to $200,000 nationwide. The legislation returned by the other body to the Senate late year, and the proposal now before this Committee, does not include that provisions. In its place, there is only a two-year limitation on a debtor's ability, in some states, to claim an unlimited homestead exemption. That provision invites the continuation of state-sanctioned abuse that cheats creditors out of their money and that cheats this country out of a law that is fair and balanced.

Just last month, a Florida citizen, Paul Bilzerian used that state's unlimited homestead exemption to cheat his creditors. He filed for bankruptcy in 1991. He now has filed for bankruptcy again. Yet he retains his $5 million Florida home, which no one can touch—not the government and not his other creditors that, together, claim $200 million in debt owed to them. Today, Mr. Bilzerian is in jail, but he stills owns that home with all of the equity in it. The provisions of this would not change that. By contrast, if the Kohl-Sessions amendment were part of this proposal and became law, he might still be in jail, but his creditors would not be paying part of his penalty.

The National Bankruptcy Review Commission conducted 21 public hearings and meetings in 1996 and 1997, and it received more than 2,300 submissions from people across the country interested in a fair and balanced bankruptcy system. A consistent theme emerged from that process. The bankruptcy system should reflect the values of this country. Most states, for example, offer a homestead exemption because, as a society, we place a high value on home ownership and the stability it can provide. Most states do not offer an unlimited homestead exemption, however, because creditors are entitled to be repaid if there is a legal basis for repayment and the debtor has the ability to repay. Unlike the insolvency systems in many countries, the law of this country recognizes the economic benefit of a second chance for businesses and for families: while we are altruistic, we also are pragmatic.

These are parts of this bill that could be passed today—without strong objection and with obvious benefit. The family farm bankruptcy provisions in Chapter 12, the translational insolvency system established in the bill and the elimination of mandatory district court appeals provide the best, but not the only, examples. Other parts of the legislation require serious attention and amendment. While that might be done on the Senate floor, this Committee—particularly with the expertise of its members—is in the best position to make the changes and additions the bill requires and, in the process, to ensure that the bankruptcy system continues to represent this country's values.

Senator SESSIONS. Mr. Beine, I understand you are with Shoreline Credit Union and have a unique perspective to share with us. I see that you are a credit union president.

STATEMENT OF KENNETH H. BEINE, PRESIDENT, SHORELINE CREDIT UNION, TWO RIVERS, WISCONSIN

Mr. BEINE. Thank you. Good morning, Chairman Hatch and other members of the committee. I am Kenneth Beine, President of

Shoreline Credit Union in Two Rivers, Wisconsin, a $50 million State-chartered, federally insured credit union. 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 committee is holding today's hearing on bankruptcy abuse prevention legislation, S. 220.

Credit unions have consistently had three top priorities for bankruptcy reform legislation: a needs-based formula, mandatory financial education, and maintenance of the ability of credit union members to voluntary reaffirm their debts.

Last year's conference report, while a product of compromise, did a good job of balancing these issues. We strongly urge the 107th Congress to pass this compromise bill as soon as possible. Any further dilutions may result in this bill not addressing the real bankruptcy problems facing America's consumers.

CUNA strongly supports the provisions in S. 220 that require a person contemplating bankruptcy to receive a briefing about available credit counseling and assistance in performing a budget analysis, and prohibits a 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 educational requirements to give debtors the tools they need to make wise decisions about filing for bankruptcy, and more importantly to succeed financially after bankruptcy. I am confident that early financial education would have helped some young adult members of Shoreline Credit Union to make different decisions than they did.

In one case, a couple in their mid–20's decided they wanted a clean slate prior to getting married. They ran up credit card purchases, one pre-paid on an auto loan with us to have a cosigner released, the father. Both were employed full-time. They both then filed Chapter 7. My credit union's share of their version of financial planning was a write-off of approximately $3,000 in credit card debt, plus another couple hundred dollars in disposal of the auto.

Credit unions strongly believe that reaffirmations are a benefit both to the credit union, which would avoid a loss, and to the member debtor, who by reaffirming with their credit union continues to have access to financial services and to reasonably priced credit.

As not-for-profit financial cooperatives, losses to credit unions have a direct impact on the entire membership due to a potential increase in loan rates or a decrease in interest on savings accounts. CUNA is pleased that S. 220 preserves the ability of its members to voluntarily reaffirm their loans. CUNA could not support bankruptcy reform legislation that undermined the ability of credit unions and their members to work out reaffirmation agreements.

Perhaps the best demonstration of the credit union movement's position that reaffirmation benefits both the member and the credit union comes from another real-life example. We had a middle-aged couple file for Chapter 7 in 1999 due to several medical problems and a loss of employment. They reaffirmed their automobile loans with Shoreline. Although not required to repay their credit card loans, they were adamant about doing so, and did so quite voluntarily after discharge. Needless to say, today they are members in good standing and only ask to be granted future loans.

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 of their debts should be required to file a Chapter 13, rather than have all their debts erased in Chapter 7.

Therefore, CUNA supports the needs-based provision that is contained in S. 220. This provision was a compromise developed out of the bankruptcy reform bill that received overwhelming support in the 106th Congress. The 106th Congress strongly supported needs-based bankruptcy, and CUNA supported these efforts. Today's hearing shows that the 107th Congress is continuing to move toward passage of bankruptcy abuse reform legislation, and we hope that bankruptcy reform will become law in the coming months.

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

Senator SESSIONS. Thank you very much.

[The prepared statement and attachments of Mr. Beine follow:]

STATEMENT OF KENNETH H. BEINE, PRESIDENT, SHORELINE CREDIT UNION

Kenneth Beine, president, Shoreline Credit Union, in Two Rivers, Wisconsin.

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.

Last year's conference report, while a product of compromise, did a good job of balancing these issues. We strongly urge the 107th Congress to pass this compromise bill as soon as possible.

Any further dilutions may result in this bill not addressing the real bankruptcy problems facing America's consumers.

The current near-record level of filings has occurred in the best of economic times.

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.

CUNTA supports the needs-based provision that is contained in S. 220. This provision was a compromise developed out of the bankruptcy reform bills that received overwhelming support in the 106τη Congress.

CUNTA strongly supports the provision in S. 220 that requires a person contemplating bankruptcy; to receive a briefing about available credit counseling and assistance in performing a budget analysis. We also strongly support the provision in this legislation that would prohibit the chapter 7 or 13 debtor from receiving a discharge if the debtor does not complete a course in personal financial management.

Credit unions are not-for-profit financial cooperatives, therefore 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.

CUNTA could not support bankruptcy reform legislation if any amendment would undermine the ability of credit unions and their members to work out reaffirmation agreements.

Good morning, Chairman Hatch and other members of the Committee. I am Kenneth Beine, president of Shoreline Credit Union in Two Rivers, Wisconsin, 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 Committee is holding today's hearing on bankruptcy abuse prevention legislation, S. 220. 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. Last year's conference report, while a product of compromise, did a good job of balancing these issues. We strongly urge the 107th Congress to pass this compromise bill as soon as possible. Any further dilutions may result in this bill not addressing the real bankruptcy problems facing America's consumers.

Shoreline is a $50 million state-chartered, federally insured credit union. We have a community-based charter, serving everyone who lives or works in Manitowoc County, and have almost 12,000 members. Currently we have $38 million in loans to our members-some $14 million in car loans, more than $16 million in home-secured loans, and almost one-half million in personal loans. In addition, we have issued about 1,600 credit cards for another $1.5 million.

Nationwide, non-business bankruptcy filings were almost 925,000 in the first nine months of 2000. While final full-year data is not yet available, the results from the first nine months suggest that full-year filings will exceed 1.2 million—very close to the 1.39 million record level of 1998. The 2000 total is likely to be about 4 percent lower than in 1999, but viewed in a broader historical context the results are disturbing: 1.2 million felines is double the national total in 1989 and four times higher than the total in 1984.

Furthermore, the current near-record level of filings has occurred in the best of economic times. The U.S. economy grew at its fastest annual pace in 16 years in 2000 and unemployment rates hovered near 30-year lows throughout the year. As the economy slows, the number of filings will undoubtedly begin to climb. We expect overall filings to grow by roughly 5 percent in 2001, though some industry experts believe the increases ;will be even higher. In fact, according to SMR Research, bankruptcy filings are predicted to increase nationwide in 2001 by up to 20 percent to record heights for a variety of economic reasons.

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 220,000 credit union member-borrowers will file in 2000. This figure is nearly 66 percent higher than the level of filings we witnessed just six years ago. In addition, CUNA estimates that over 40 percent of all credit union losses in 2000 will be bankruptcy-related, and those losses will total approximately $475 million.

In Wisconsin we expect a 2.5 percent increase in the total number of credit union borrower bankruptcies in 2000. This translates to a total of roughly 4,150 filings.

At Shoreline Credit Union, bankruptcy filings and losses have shown a steady increase since 1996. In 1996 we had 1 member who filed for bankruptcy; in 1997 we had 3; 1998 brought 5 filings; in 1999 it rose to 8; and we hit 10 in 2000. We had only one Chapter 13 bankruptcy filing during the same period. In our case over 60 percent of our chargeoffs are Chapter 7 filings.

As the number of member bankruptcies has increased, so too have the dollar losses to my credit union. Our loss from the one bankruptcy in 1996 was only $1,875, but in just one year the losses increased to $9,883—an increase of over 500 percent. As noted in the Fact Sheet attached to my testimony, our bankruptcy losses have doubled each of the past three years.

Shoreline 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.

In an effort to combat the number of bankruptcies at the credit union, Shoreline has tightened its credit policies. We now use bankruptcy predictors as part of the credit granting process. We have increased collateral requirements and opt to require a cosigner or co-maker on more loans than in the past. We do not reissue cards to those members who are overextended or have a poor repayment history with the credit union. We are also looking into introducing "risk-based lending" procedures in the near future.

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.

CREDIT UNIONS SUPPORT FINANCIAL EDUCATION

Credit unions clearly recognize the value of financial counseling for their members. According to a recent CUNTA 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. Shoreline 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. We address credit issues in our newsletter and recently added a consumer credit session to our annual spring Home Buying Seminar series.

CUNA strongly supports the provision in S. 220 that requires a person contemplating bankruptcy to receive a briefing about available credit counseling and assistance in performing a budget analysis. We also strongly support the provision in this legislation that 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.

We also strongly support amendments to Section 527 that would require a debt relief agency providing bankruptcy assistance to analyze the benefits of different forms of debt relief with the debtor and to emphasize the need for full and accurate disclosure of assets, liabilities and income.

CUNA is also an active supporter of the Youth Financial Education Act (H.R. 61) as introduced by Representatives David Dreier (R–CA) and Earl Pomeroy (D–ND). This legislation would authorize 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.

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 S. 220, as well as the provision encouraging states to develop personal finance curricula for elementary and high schools.

Financial education is a high priority for our national trade association. Last year, CUTA and the National Endowment for Financial Education (NEFE) entered into a partnership whereby 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.

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.

I am confident that early financial education would have helped some young adult members of Shoreline Credit Union to make different decisions than they did. In one case, a couple in their mid-twenties decided that they wanted a "clean slate" prior to getting married. They ran up credit card purchases. One prepaid on an auto loan with us to have the cosigner released. (Both were employed full-time.) They both then filed for Chapter 7. My credit union's share of their version of financial planning was a write-off of almost $3,000 in credit card debt plus another couple of hundred dollars on the disposal of the auto.

In another case, an expectant young mother who lived at home with her parents (with a stable part-time job and a small automobile loan at Shoreline) wanted to quit her job, but didn't want to "burden her child with her credit problems," and asked if we would accept the car in full payment of the loan balance. My loan officer offered to rewrite the loan terms or suspend payments for several months and also informed her that she would still be responsible for the remaining balance on the loan after the sale of the car. She was not interested. She subsequently filed Chapter 7 and turned over the vehicle to us. We incurred about a $3,000 loss.

Even with financial counseling, I recognize there are instances in which bankruptcy may be the only alternative for some members, the way for them to get a much needed "fresh start." But I am not convinced that in either of these examples, bankruptcy was the right solution.

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 support bankruptcy reform legislation if any amendment would undermine 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. The bankruptcy bill that eventually passed by both houses and presented to the President in December, however, contained a lengthy disclosure statement for reaffirmations, which is contained in Section 203 of S. 220. The form is intended to assure that debtors entering into a reaffirmation agreement understand all aspects of signing that contract. CUNA appreciates the work of this committee, and the work of Senators Jeff Sessions (R–AL) and Jack Reed (D–RI), to recognize in the Section 203 language the unique relationships that credit unions have with their members.

Shoreline, 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.

Perhaps the best defense of the credit union movement's position that reaffirmation benefits both the member and the credit union is to provide another real life example. We had a middle aged couple file for Chapter 7 in 1999 due to several medical problems and loss of employment. They reaffirmed their automobile loans with Shoreline. Although not required to repay their credit card loans, they were adamant about doing so, and did so quite voluntarily after discharge. Needless to say, today they are members in good standing, and need only ask to be granted future loans.

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 S. 220. This provision was a compromise developed out of the bankruptcy reform bills that received overwhelming support in the 106th Congress.

Let me tell you about a case at my credit union that illustrates why needs-based bankruptcy and its provisions are needed. A young woman had an automobile loan from Shoreline Credit Union, with her mother as a co-signer. The daughter fell behind on the payments, and the mother offered to take over the loan completely if the credit union was willing to remove the daughter's name from the loan. Since the mother had a good credit and employment history, we agreed to do so. The woman filed for Chapter 7 before the due date of the first payment. We lost $6,000. We eventually learned that she had previously filed for bankruptcy and "didn't want her daughter to have the same credit problems."

What this member did borders on fraud. People should not be able to use the bankruptcy code as a tool to avoid inconvenient obligations by transferring their debts to fellow consumers—my members—your constituents. This is wrong. This is abuse.

You have the power to make it right.

Again, let me say that I am pleased you are holding this hearing today. Credit unions are very anxious to see Congress enact meaningful bankruptcy reform and believe that a needs-based bankruptcy system presents the best opportunity to achieve this important public policy goal. The 106th Congress strongly supported needs-based bankruptcy, and CUNA supported these efforts. These hearings that are being held on S. 220 show that the 107th Congress is continuing to move toward passage of bankruptcy abuse reform legislation, and we hope that bankruptcy reform will become law in the coming months.

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

FACT SHEET

Total Assets:	$50.5 million (data as of December 2000).
Members:	11,700.
Total Loans:	38.0 million.

Losses Due to Bankruptcy:

2000	522,375
1999	534,577
1998	15,309
1997	9,883
1996	1,875

Number of Filings:	Chapter 7	Chapter 13	Total
2000	10	0	10
1999	7	1	8
1998	5	0	5
1997	3	0	3
1996	1	0	1

GEORGE R. YACIK
SMR RESEARCH CORPORATION
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BANKRUPTCIES WILL RISE STRONGLY IN 2001; RESEARCH FIRM PREDICTS "FLOOD OF FILINGS"

Hackettstown, NJ 09/21/00. Personal bankruptcy filings will begin to rise this year and are likely to grow by 10% to 20% in 2001, SMR Research Corp. forecast today.

The new rising trend will mark the end of a mild bankruptcy down-cycle. Personal filings reached record levels in 1998, and then receded a bit in 1999. In the first two quarters of 2000, bankruptcies continued to decline, but only slightly.

SMR said it expects data for the third quarter of 2000 to show a slight increase in personal filings from June levels, followed by a stronger increase in the fourth quarter. In 2001, there will be a flood of fillings, SMR predicted.

Total filings in 2001 probably will set a new national record, exceeding those of the prior record year, 1998.

SMR is a market research and predictive modeling firm that specializes in consumer financial subjects. SMR operates a database of bankruptcy filings and trends at the national, state, county, and metro area levels, updated quarterly and with a history back to 1989. SMR makes annual forecasts on national trends in personal bankruptcies.

"What we're now seeing is the impact of the new interest rate cycle, made a little worse by rising energy costs," declared SMR President Stuart A. Feldstein. Changes in long-term interest rates tend to impact the bankruptcy rate with about a 1-year lag, so rising rates in 1999 are now starting to hit home.

In news releases in 1998 and '(999, SMR correctly forecast the bankruptcy decline in 1999, and also the impending increase in the second half of 2000.

Interest rate movements are not the major cause of bankruptcy filings, but do modify the trend. Most of the central causes of bankruptcy have been growing worse since the mid-1980s, as has the overall bankruptcy filing rate. The main causes, highlighted in various SMR published studies, include:

- Growth in consumer debt relative to income caused by too much spending;
- A host of worsening socio-economic problems, including a long-time increase in the percent of adults who are divorced and increased numbers of Americans lacking any form of health insurance;
- A decline in household liquid savings as a "rainy day" cushion—especially among middle class people;
- Increased advertising promotion of bankruptcy by lawyers, and
- Increased credit-risky behavior, such as casino gambling.

In calendar 1998, total personal filings reached a record high at 1.38 million, not counting U.S. territories or persons living overseas. This number was up from only 0.77 million as recently as 1994.

In 1999, filings fell to 1.26 million. But for 12 months ended March 31, 2000, the number of filings was 1.24 million, showing that the declining trend of 1999 had nearly petered out.

Based on its research, SMR believes that third quarter 2000 data will show the annualized filing rate to be up slightly from the second quarter of 2000. Fourth quarter 2000 numbers, when available, should show a well-developed upward bankruptcy trend.

The danger for 2001 is that it will mirror events in 1996, when bankruptcies exploded by more than 28% from the prior year. In the interest rate cycle, 2000 looks similar to 1995 and 2001 may look a lot like 1996. Calendar 1995 was the last time a bankruptcy decline leveled off, and in 1996 the floodgates opened.

"This time around, the snap-back in 2001 could be powerful," Feldstein said. "Aside from interest rates, we now have fast-rising energy and electricity costs. These impact people in danger of bankruptcy more than they impact highly solvent consumers."

Indeed, SMR's bankruptcy forecast for 2001—a 10%–20% filings increase might have been even higher. However, the increase in interest rates in 1999 and 2000 hasn't been quite as severe as it was in the fast period of rising rates.

Interest rate changes modify what otherwise has been a long-term increase in bankruptcies, SMR noted. Since 1985, bankruptcies have declined only in years following periods of sharply reduced long-term interest rates. They never declined as low as in previous troughs. And when rates rose again, bankruptcies increased sharply about one year later.

SMR's forecast is based on the assumption that federal bankruptcy laws will be unchanged. Bills to toughen bankruptcy rules have been pending in Congress for the last few years, but haven't been passed. One reason is that when passage seemed most imminent in 1999, the number of filings fell. Some legislators hoped the problem in bankruptcies was about to fix itself.

"People who still think that will be in for a rude awakening very shortly," said SMR's Feldstein. "Nothing has changed in the underlying causes of personal bankruptcy, nearly all of which continue to worsen."

If new and tougher bankruptcy legislation is passed in 2001, SMR's forecast would change.

As currently written, the legislation would take effect six months after passage. During those six months, there likely would be an explosion of filings, as lawyers would advise their clients to make use of the existing law. Afterwards, the effect of new legislation would depend on its precise content.

Senator SESSIONS. Dr. Manning, you are a Senior Research Fellow at the Institute of Higher Education, Law, and Governance at the University of Houston Law Center. We are glad to hear from you now.

STATEMENT OF ROBERT D. MANNING, SENIOR RESEARCH FELLOW, INSTITUTE FOR HIGHER EDUCATION, LAW, AND GOVERNANCE, UNIVERSITY OF HOUSTON LAW CENTER, HOUSTON, TEXAS

Mr. MANNING. Thank you, Mr. Chairman and members of the committee. I would like to share a somewhat different perspective as an economic sociologist and some of my research of the last 15 years of studying the impact of U.S. industrial restructuring on the standard of living of various groups in American society.

Over the last 10 years, I have been particularly interested in the role of consumer credit in shaping the consumption decisions of Americans, as well as the role of retail banking in influencing the profound transformation of the financial services industry.

I have studied the rise of the credit card industry, in general, and the emergence of financial services conglomerates such as Citigroup during the deregulation of the banking industry in 1980, and the results of my research are summarized in my new book *Credit Card Nation*.

I think if we take a somewhat global perspective, I would like to use the analogy of the American economy as an athlete who uses steroids to temporarily exaggerate muscle mass and to boost physical strength.

The U.S. economy, I believe, has been perilously inflated through the enormous increase of debt over the last two decades. Across all sectors of U.S. society, whether it is household, government or corporate, access to easy credit has led to pervasive dependence on debt.

Like the myriad of medical maladies that eventually afflict steroid abusers, the negative long-term consequences of social debt have been neglected during the past decade of unprecedented economic growth. Indeed, what we have seen is a tremendous shift in emphasis from savings to debt, the emergence of products such as the City Sony credit card, the currency of fun, the emergence of young adults that refer to their credit card as yuppie food stamps.

The economic expansion of the last decade, I do not believe was as strong as described by leading economic indicators due to bank lending policies that promoted inflated consumer expectations through easy access to high-cost consumer loans, whose interest rates far exceed the pace of household income growth.

I think the point that I want to make very clear is it is not just debt, but it is the cost of this debt that is going to have such a profound impact on whether this economic slowdown will progress to a consumer-led recession. Indeed, similarly, the economic indicators do not necessarily imply a consumer-led recession if leading financial services conglomerates like Citigroup and Bank of America, J.P. Morgan and Chase do not overreact to the abrupt decline in national economic growth.

The concern is that these financial service corporations may tighten their lending policies for small businesses, the primary generator of U.S. jobs, and the heavily indebted families that previously were considered acceptable credit risks. I can't overestimate what I think is the importance of this issue today.

This may not only limit future levels of business investment and household consumption which could exacerbate a downward spiral in macroeconomic growth, but it could also force tens of thousands of financially distressed households into personal bankruptcy, due to unforeseen events. As the most comprehensive analysis of bankruptcy in the early 1980's shows, most bankruptcy filings are attributed to unforeseen events, such as job loss, health and medical expenses, and divorce, rather than simply excessive consumer spending patterns.

Surprisingly, the consumer financial services industry has responded by reducing the fair share contributions to non-profit consumer credit counseling organizations and the need for financial education at the same time that the demand for these services are rapidly escalating.

Like replacing small business loans with high-interest credit cards, the question is whether the financial service industry is truly committed to reducing the national rate of consumer bankruptcies by supporting institutionally responsible policies that balance the often unrealistic consumption desires of American households.

The renewed efforts of the financial service industry to enact more stringent personal bankruptcy laws could lead bankers to exacerbate a national economic slowdown by forcing financially insolvent households to continue paying off a portion of their consumer debt years after filing for personal bankruptcy. This is not a propitious time for enacting such a painful and often devastating policy on some of America's most vulnerable households.

The present legislative proposals tend to reflect a societal context of rapid economic growth rather than current realities of an unexpected economic slowdown. The U.S. economy needs greater stimulation through increased consumer demand rather than curtailing the future buying power of a large segment of the U.S. population.

The industry's call for greater individual responsibility belies its disregard for its own traditional underwriting criteria. For the record, I have provided excerpts of the hundreds of interviews that I have conducted in terms of perceptions of easy access to credit. Indeed, what is striking about the credit card nation is that grandparents with stellar past job histories are often rejected for credit cards, while their grandchildren who have never had a full-time job are inundated with solicitations while in college. Similarly, recent college graduates may be rejected for credit cards after graduation, but as soon as they do graduate their low salaries lead them to a rejection for their credit card debt.

A striking finding of my study of credit cards among students and their debt levels is that recent graduates of the late 1980's and early 1990's were more likely to assume most of their credit card debt while seeking gainful employment rather than when they were enrolled in college. Today, college students are routinely graduating with credit card debts of $5,000 to $15,000 before they even have a full-time job, plus their student loans, before they enter the job market.

With the specter of a tight job market in the near future and the continued corporate promotion of inflated consumer expectations, it can be expected that the bankruptcy rate of recent college graduates will continue to soar, with potentially disastrous long-term consequences. Indeed, the fastest growing group of bankruptcy filers last year were individuals under 25 years old.

The recent assumption of tremendous levels of consumer debt provided by financial service institutions that have routinely ignored their traditional underwriting criteria—and I especially refer to the marketing of credit cards to college students—requires accountability and financial responsibility from both sides, borrowers as well as lenders. Lending policies that routinely require the poor and heavily indebted to subsidize the low and even free cost of credit card loans to the affluent through escalating interest rates and penalty fees does not reflect an appropriate policy of shared individual as well as institutional responsibility.

In fact, the increasing financial obligations of filers to their creditors after bankruptcy could encourage banks to continue extending easy credit to those least able to assume their financial responsibilities during a period of economic uncertainty and distress.

Senator SESSIONS. Dr. Manning, the time has expired, if you will wrap up I would appreciate it.

Mr. MANNING. Banks and other financial institutions should share the pain as well as the gain associated with liberal extension of high-cost consumer credit. Otherwise, consumer lending policies of financial institutions may continue to discourage the promulgation of prudent and responsible underwriting policies. It is my hope that the final form of this legislation will promote personal responsibility as well as corporate accountability.

Thank you.

Senator SESSIONS. Thank you.

[The prepared statement of Mr. Manning follows:]

STATEMENT OF ROBERT D. MANNING, SENIOR RESEARCH FELLOW, INSTITUTE FOR HIGHER EDUCATION, LAW AND GOVERNANCE, UNIVERSITY OF HOUSTON LAW CENTER, HOUSTON, TEXAS

I would like to thank the Committee for this opportunity to contribute to ongoing discussions over proposed legislative reforms of existing consumer bankruptcy law. As an economic sociologist, I have spent the last 15 years studying the impact of U.S. industrial restructuring on the standard of living of various groups in American society. Over the last 10 years, I have been particularly interested in the role of consumer credit in shaping the consumption decisions of Americans as well as the role of retail banking in influencing the profound transformation of the financial services industry. In regard to the former, my research includes indepth interviews and lengthy survey questionnaires with over 800 respondents. In terms of the latter, I have studied the rise of the credit card industry in general and the emergence of financial services conglomerates such as Citigroup during the de-regulation of the banking industry beginning in 1980. The results of this research are summarized in my new book, CREDIT CARD NATION: America's Dangerous Addiction to Consumer Credit and are updated on my web site at www.creditcardnation.com.

THE EXPLOSION OF U.S. CONSUMER CREDIT:

LONG-TERM PERFORMANCE ENHANCER OR SHORT-TERM MIRACLE DRUG?

Like an athlete who uses steroids to temporarily exaggerate muscle mass and to boost physical strength, the U.S. economy has been perilously inflated through the enormous increase of debt over the last two decades. Across all sectors of U.S. society (household, government, corporate), access to easy credit has led to a pervasive dependence on debt, much like American's addiction to low cost energy supplies. And, like the myriad of medical maladies that eventually afflict steroid abusers, the negative long-term consequences of societal debt have been neglected during the past decade of unprecedented U.S. economic growth.

Most Americans would be surprised to learn that total consumer debt, including home mortgages (over $6.5 trillion), exceeds the cumulative U.S. national debt ($5.7) trillion. And, like the sharp increase in federal borrowing that augmented the modest growth of federal revenues over the last 20 years (U.S. national debt totaled ($940 billion in 1981), consumers have become increasingly dependent on unsecured or "revolving" credit (about $55 billion in 1981) to compensate for stagnant real wages, increasing employment disruptions, and higher costs for big ticket items such as automobiles, college tuition, insurance, housing, and health/medical costs. Although the finance charges on the national debt have grown substantially (from $292.5 billion in 1993 to $362.0 billion in 2000), accounting for over 12 percent of the current federal budget, heavily indebted consumers are facing a more serious financial burden since their loans are more likely to be in the form of higher interest credit cards (average of over 18% APR) versus more modest Treasury bonds (5%–6%).

At the same time that "one-stop" financial shopping has provided greater convenience and lower prices for a small minority of U.S. households, the most economically disadvantaged or financially indebted are increasingly relegated to the "second tier" of the financial services industry (pawnshops, rent-to-own stores, 'payday' lenders) where interest rates typically range from 10 to 40 percent—and more—PER MONTH! Significantly, this fastest growing segment of the financial services industry features the participation of some of the largest "first-tier" banks such as Wells Fargo, Goleta National Bank, and Bank of America. To the dismay of most Americans, the deregulation of the financial services industry has led to record revenue growth and profits for banks while providing more complex pricing systems, less personalized service, and sharply increased costs to the majority of consumers. In sum, while U.S. wages in general and household income in particular have typically declined over the last two decades, the effective demand of American consumers has been enhanced by their access to increasingly higher cost credit. This trend is especially significant since the U.S. post-industrial economy has been fueled by the growth of consumer related goods and services—accounting for about ⅔ of America's economic activity (Gross Domestic Product). As long as U.S. consumer demand has increased, stagnant real wages (from mid-1970s to late 1990s), declining labor benefits (health, pension), and the growth of temporary or "contingent" workers (from 417,000 in 1982 to 1.22 million in 1989 and to 2.66 million in 1997) have been obscured by the unprecedented extension of consumer—especially "revolving" credit.

Like steroid abuse, the dramatic decline in the U.S. personal savings rate (from nearly 8.5% in the early 1980s to less than zero today) and the sharp rise in consumer debt could have long lasting effects on the U.S. economy. Since the end of the last recession (1989–91), the Federal Reserve reports that total installment consumer debt (credit cards plus consumer loans such as autos and appliances) rose from $731 billion in 1992 to about $1.5 trillion today. This includes a huge increase in unsecured credit card debt: from $292 billion in 1992 to $654 billion at the end of 2000. A remarkable trend since credit card debt was only $50 billion in 1980. Together with the sharp increase in stock market valuations during the 1990s ("wealth effect ") and the corporate promotion of immediate gratification ("Just Do It" consumption) which inflated consumer expectations, Americans have tended to purchase more than they could possibly afford on their household income. Not surprisingly, this was facilitated by the aggressive marketing of bank and retail credit cards to traditionally neglected groups such as college students, senior citizens, and the working poor. It is sobering that the recent decade of economic growth and falling unemployment has featured a perplexing phenomenon: personal bankruptcy rates in the late 1990s (peaking at 1.4 million in 1998) soared to nearly ten times the rate of the Great Depression.

Not only are most U.S. households being squeezed by mounting mortgage and consumer debt, but the "real" cost of borrowing has risen dramatically since the de-regulation of banking in 1980. For instance, the real cost of corporate credit (prime rate) has increased only marginally (2.5%–3.0%) whereas the real cost of consumer credit card debt has more than doubled (less than 6% to over 11 %) since the early 1980s—not to mention soaring penalty fees (about one-third of all credit card revenues). Furthermore, even the robust wage increases of the last three years do not compensate for the rising cost of financing personal debt; only home mortgage related interest is tax deductible.

Today, three out of five U.S. households are responsible for the approximately $560 billion in outstanding credit card debt.[1] Among these "revolvers," credit card debt averages over $11,000 per household. Hence, a four percent increase in the an-

[1] This figure is based on a conservative estimate that approximately 9 percent of credit card debt is paid off before incurring interest charges and another 5 percent is not credit card debt. The monthly Federal Reserve Bulletin, which reports revolving and nonrevolving consumer debt levels, is available at www.bog.frb.fed.us.

nual median income of U.S. family households (about $50,000) is nearly the same as the average cost of financing household credit card debt (18% excluding fees) or approximately $2,000. And, this does not include the tremendous growth of finance companies (over 24% APR) and the rising cost of "second-tier" banks. The enormous profits of the latter explain the recent entry of the largest "first-tier" banks into providing second-tier financial services. For instance, Wells Fargo formed a joint venture with Cash America (largest U.S. pawnshop company) in 1997 to develop a state-of-the-art system of automated, payday loan kiosks. Overall, credit card interest charges, penalty fees, and second-tier finance costs could total over $140 billion in 2001. This is an enormous transfer of income to an industry that has slashed jobs, cut wages, and raised consumer prices. In terms of sustaining the current economic expansion, the effect could be a significant reduction in the effective demand of U.S. households as the purchase of goods and services is subordinated to the payment of rising finance charges attributed to previous consumption.

Before reporting on the experiences of people who have been encumbered with high levels of consumer debt, it is important to note the recent trends and institutional policies in the consumer financial services industry. First, in contrast to descriptions of the credit card industry as highly competitive with 6,000 competitors, the reality is that the last decade has witnessed a dramatic consolidation of credit card issuers. In 1977, the top 50 banks accounted for about half of all U.S. credit card accounts. The impressive revenues of most credit card portfolios has precipitated massive mergers and acquisitions over the last decade. For instance, Bank One's acquisition of credit card giant First USA in 1997 was followed by Citibank's purchase of AT&T's credit card subsidiary—the eighth largest in 1998. Today, the top ten card issuers control over three-fourths of the credit card market and nearly 70 percent of the over 1.3 trillion in credit card charge volume. Not surprisingly, competition for clients is less likely to be expressed in the form of lower prices. Indeed, it is striking that the average cost of consumer credit card debt has actually risen over the last five years.

Second, the enactment of the 1998 Financial Services Modernization Act has precipitated a new trend in the formation of consumer financial services conglomerates. For instance, the 1998 merger of Citicorp with Traveler's Group has created a new role for consumer credit cards: compiling consumer information files. Credit cards provide a lucrative revenue stream for conglomerates such as Citigroup as well as strategic information for the cross-marketing of other financial services such as insurance, investment services, student loans, home mortgages, and consumer loans. By combining different sources of consumer activities from various corporate subsidiaries (e.g. Traveler's Insurance, AT&T credit cards, Solomon Smith Barney investments), plus the forging of strategic partnerships with specific corporate retailers, these conglomerates are developing increasingly cost-effective marketing campaigns for persuading customers to use their credit for purchasing products from members of the conglomerate's extended corporate "family." It is not surprising, then, that the major credit card associations recently have begun marketing credit cards to teenagers—with the required financial contract signed by their parents or guardians. This card program is ostensibly designed to help promote financial responsibility by encouraging parents to discuss financial purchases/budgets with their minor children. Of course, financial education could be promoted through the use of debit cards or personal checks. Indeed, the key objective is to promote credit card use at an early age, especially purchases through virtual internet shopping malls. Furthermore, this credit card program facilitates the collection of consumer information at an earlier age as well as the direct marketing of teenagers without the filter and/or confusion of distinguishing the purchases of children from their parents. By issuing credit cards in a teenager's name, companies are seeking to shape consumption behavior and corporate loyalties at an earlier age while minimizing the influence of their parents.

Third, the growth of subprime credit cards has led to outrageous financial terms for the most naive and inexperienced market of the working poor. With annual percentage interest rates of over 30 percent and costly "hidden" charges, even large issuers have been formally reprimanded and even sued over duplicitious advertising. For example, the sixth largest credit card issuer, Providian National Bank, agreed to an out-of-court settlement for a record $300 million in June 2000. According to the U.S. Comptroller of the Currency, John D. Hawke Jr., "We found that Providian engaged in a variety of unfair and deceptive practices that enriched the bank while harming literally hundreds of thousands of its customers." They include a 'no annual fee' program that failed to disclose that the card required the purchase of $156-a-year plan credit-protection plan; customers who complained were informed that the plan was mandatory unless a annual fee was paid.

For those who desperately seek a credit card as a "bank account of last resort," the terms that are required of subprime applicants—especially the working poor—include unwanted educational materials and high membership fees with little available credit. This is illustrated by the conditions of the United Credit National Bank Visa. It's direct mail solicitation declares, "ACE VISA GUARANTEED ISSUE or we'll send you $100.00! (See inside for details.)" For those who bother to read the fine print, and a magnifying glass would be useful in this case, the terms of the contract are astounding,

> "Initial credit line will be at least $400.00. By accepting this offer, you agree to subscribe to the American Credit Educator Financial and Credit Education Program. The ACE program costs $289.00 plus $11.95 for shipping and handling plus $19.00 Processing Fee—a small price to pay compared to the high cost of bad credit! The Annual Card Fee [is] $49.00. . . For your convenience, we will charge these costs to your new ACE Affinity VISA card. [*They*] *are considered Finance charges for Truth-In-Lending Act purposes*."

Unbelievably, an unsuspecting applicant could pay $369 for a net credit line of only $31 at a moderate 19.8 APR. It is no wonder that those households who are most desperate for consumer credit often give up on the financial services sector after they realize the exploitative terms of these contracts.

A final issue concerns the trend of consumer financial services conglomerates of replacing traditional, low cost consumer and small business loans with higher cost substitutes. For instance, in low-income neighborhoods, this may result in the closing of a first-tier bank branch and its replacement with high cost, finance companies (such as Citigroup's newly acquired Capital Associates) or second tier "fringe banks" such as check cashing outlets, pawnshops, and rent-to-own stores. Especially disconcerting is the application of this policy to the small business sector. Today, the number one source of start-up financing for small businesses is credit cards followed by home equity loans. Aspiring entrepreneurs—especially women and minorities—are routinely denied small business loans and encouraged to assume higher cost, credit card debt. As one owner of a computer supply company explained, "1 wanted a business loan [from Wells Fargo] but all 1 got was a[nother] credit card instead." This trend has potentially serious consequences as credit cards have dramatically changed from the credit of last resort to the initial source of start-up financing. Since small businesses are the primary source of net job growth in the U.S. economy, this trend could have severe repercussions during the next economic downturn. That is, small entrepreneurs may not be able to survive unfavorable economic conditions after exhausting their high cost lines of consumer credit at the same time that the economy needs to generate more jobs. This restrictive corporate lending policy could exacerbate an economic slowdown and possibly contribute to a recession.

'PLASTIC MONEY FOR REAL PEOPLE'

—COLLEGE MARKETING CAMPAIGN BY ASSOCIATES NATIONAL BANK

The lack of individual responsibility in the assumption of escalating levels of consumer debt is the cornerstone of the credit card industry's argument for the reform of existing bankruptcy laws. The emphasis on "if you play then you should pay" belies the dramatic shift in the promotion of high interest, unsecured lines of credit which are most efficiently provided through universal or bank credit cards. As the credit card industry successfully increased the "real" cost (net of inflation) of consumer credit and saturated middle-class households in the 1980s, the spectacular profits of the consumer-debt driven economy led to banks to finance enormous marketing campaigns that sought to penetrate nontraditional markets in the late 1980s. The abrupt change in the industry's underwriting standards for these loans raises the question of whether these new, far less stringent lending criteria are encouraging American households to borrow more money than banks know they can ever possibly repay. Ironically, these new groups tend not to be engaged in full-time employment nor are they adequately educated on the lending policies of the financial services industry: college students and senior citizens.

In terms of college students, the lack of information on their consumer debt levels (obscured by student loans, private loans, direct parental payments, and other forms of family assistance), has led to the surprising discovery that the fastest growing group of bankruptcy filers is 25 years old or younger. The credit card industry has funded research studies that present an idyllic world of tech savvy and financially responsible college students that belie the escalating social problems associated with credit card debt. Through the "rose colored glasses" of the credit card industry, which claims that approximately 3 out of 5 college students pay off their charges at the end of each month, the credit card is portrayed as a "knight in shining armor" a la Jerry Seinfeld's advertisements for American Express. Instead, the flawed research methodology of these few industry sponsored studies ignores such crucial trends as the use of student loans to pay credit card debts (80% of college students are enrolled in public schools), surveys that explicitly exclude students that have dropped out of college due to high credit card debts, informal family loans or payments for reducing high interest credit card debt, supplementary private loans for paying off credit card debts, and inclusion of parents' credit cards (where students are secondary card users that are not responsible for monthly charges).[2] Furthermore, by focusing on the lifestyle enhancements that credit cards offer to "mature" students, public attention has been directed away from the social problems that have emerged from their unprecedented expansion over the last decade. These include physical maladies (from anxiety, excessive smoking and drinking, depression), parental authority conflicts, loss of scholarships due to extra jobs for monthly payments (low grades), job rejection, denial of auto and home mortgage loans, rejection for student loans for graduate and professional school, decline of apartment rental applications, increasing defaults on federal student loans, and, in the most extreme cases, student suicides; the latter was recently reported in a Sixty Minutes II program (www.cbs.com and www.creditcardnation.com). Not incidentally, the sharp increase in consumer debt among college students has defied the recent decline in consumer bankruptcies; last year, the number of bankruptcy filers 25 years old or younger jumped to nearly 150,000. In view of the enormous increase in consumer credit offered to college students and the ongoing slowdown in the U.S. economy, the experiences of recent college graduates offers instructive insights into industry responsibility in the rapidly growing group of bankruptcy files. Significantly, the case-studies reported in my 1999 study include students whose parents emphasized the importance of credit as a convenience and debt as a moral vice.[3] Even in these cases, the promotion of credit cards on college campuses—where universities "earn" multi-million dollar annual royalties for exclusive credit card marketing agreements—quickly erodes cautious family values toward the use of consumer credit and the accumulation of debt.

For example, beginning with his middle-class upbringing in Indiana, where his father inculcated the Midwestern values of frugality and debt avoidance, Jeff entered Georgetown University in 1995 with a commitment to conduct his financial affairs on a cash-only basis. Initially, he socialized with students like himself—from moderate income Midwestern families—whom shared similarsocial backgrounds and cultural experiences. But, Jeff soon realized that he wanted to transcend his family background and enjoy the more exciting lifestyle of his more affluent and urbane friends such as his roommate. At first, his adherence to the 'cognitive connect' (i.e.; that his income/resources must determine consumption) made him "stand out" among his peers. For instance, Jeff's father always paid restaurant bills in cash. His motto is, "if you don't have the cash then you shouldn't buy it." Jeff's new friends, however, associated this behaviorwith the quaint and backward cultural practices of Depression era farmers. Rare is the situation when their parents use cash for common financial transactions.

This clash of cultures led Jeff to apply for a credit card. He received two credit cards his first semester including a Gold MasterCard. Although Jeff initially obtained his credit cards for convenience, he was impressed by the favorable response of others to his Gold credit card, "It made me feel like I had made it. . . people treated me different when they saw [the Gold card]." Jeff acknowledges that this new respect was premature, since he did not yet have a 'real' job, but perceived it as an early recognition of his future social status as a graduate from a prestigious university. Significantly, Jeff first began using his credit cards like cash, paying off the balances at the end of the month, "Why pay cash. [Afterall] what's the point of having a credit card." His other reason for obtaining credit cards was for emergencies. Hence, as long as Jeff's savings and loans could finance a carefree lifestyle, his credit cards served as a modern convenience that befitted his status as a student at an elite, private university. Of course, this situation quickly changed when his financial resources were exhausted in the fall of his sophomore year.

As a freshman, Jeff saw his credit cards as his best friend, an angel of mercy during crisis situations, "At first, I decided that my credit cards would only accumulate

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[2] See Robert D. Manning, "Credit Cards on Campus: Current Trends and Informational Deficiencies," Consumer Federation of America, 1999 available at www.creditcardnation.com.

[3] See Robert D. Manning, "Credit Cards on Campus: The Social Consequences of Student Debt," Consumer Federation of America, 1999 available at www.creditcardnation.com and Robert D. Manning "Credit Cards on Campus: The Social Consequences of Student Credit Dependency' in *Credit Card Nation: The Consequences of America's Addiction To Credit* (Basic Books, 2000).

debt in case of emergencies, such as being stranded in an airport and needing a [plane] ticket. After a while, i decided that it was okay to charge necessary things like books and other school related expenses. . . . Then, after charging for 'needs;' it was just so easy.. I decided that it was okay to charge anything I damn well wanted." As his debt increased, with 8 new credit cards during his sophomore year, Jeff became disheartened. Although they enabled him to rebel against the strict social control of his father, Jeff was now encumbered with several thousand dollars of debt. Over time, Jeff confounded his pursuit of personal independence with the rejection of the cultural ethos of the 'cognitive connect.' Afterall, he argued, consumer debt it is a common—even modern—trend of professionally successful people and "everyone else I knew was in debt. . . . and so were many of their parents." Among his peers, they rationalized their indolent spending behavior by emphasizing "the great jobs that we will get [after graduation] that will enable us to pay off our credit card [debts]."

At the onset of his college career, Jeff's conservative Midwest background made him a most unlikely candidate for accumulating a large credit card debt. However, with tuition over $23,000 per year at Georgetown University, Jeff quickly exhausted the $40,000 "loan" that his parents saved for his college education. And, with a combined household income of over $100,000, his financial aid was primarily limited to student loans. Unlike students at less costly public colleges, moreover, Jeff was not able to transfer any of his personal debts into student loans. This is because Jeff's student loans paid only a fraction of Georgetown's tuition while his duties as an oncampus resident hall advisor (RA) provided his room and board. Jeff's family inculcated the importance of adhering to the 'cognitive connect' of consuming only what could be paid in cash; credit card use was acceptable only if one had sufficient savings or earnings that "could back up your purchases." initially, Jeff succumbed to the temptations of credit cards for non-economic reasons. They offer emotional security in case of personal "emergencies" and alleviate social status anxiety because "people treat me so much better when they see my Gold [American Express, MasterCard] cards." Jeff's first credit card was an impulsive response to a Citibank advertisement "that was hanging on the wall in the dorm." The Visa card offered a credit limit of $700 with an introductory rate of 4.9%. By the end of his freshman year, Jeff had received three credit cards which were used primarily for entertainment-related activities.

The shift from using credit cards for convenience to financing an inflated standard of living was a normal extension of Jeff's college experience. As he explains, "Everyone has to take on debt to go to college. . . . everyone is expected to have student loans. . . . Even in my Midwestern [culture] which emphasizes that debt is bad, college loans are viewed as good debt. . . . Low interest rates. . . . High price of college equals high value. . . . [produces] a greater return on your investment." By the middle of Jeff's sophomore year, he had exhausted his parents' college "loan." At this point, he confronted a profound crossroads in his college career. Either he fundamentally altered his consumer oriented lifestyle or abandon his familial attitudes toward debt. Faced with the choice of losing his more "sophisticated" and urbane friends, whom view debt as a necessary means to a justifiable end, Jeff easily accumulated 8 more credit cards in 1997.

The most striking feature of Jeff's credit card use is how quickly he abandoned the virtue of frugality as a necessary means for establishing his own social identity outside of his father's strict control. Afterall, the culture of consumption that permeates collegiate life views saving as a practice of "hicks" while debt is the "breakfast of champions." By the end of his sophomore year, Jeff had accumulated a couple of thousand dollars in credit card debt. Instead of beginning his junior year with savings from his summer job, most of Jeff's earnings were used to pay off his credit cards. Significantly, as his credit card balances rose, Jeff received congratulatory letters from credit card companies extolling his good credit history and raising his credit limits as a "courtesy to our best customers" so that he could avoid over limit fees. Although he has never earned $10,000 in annual income, the deluge of credit card offers obscured the fragility of his Jeff's financial circumstances, "with the constant arrival of new 'pre-approved' credit card applications AND the raising of my credit limits the credit card companies made it seem like [my level of debt] was okay. . . . When I started to fall behind, I even received letters that allowed me to 'skip a payment' because the company 'understood' that sometimes debts can back-up such as during the holidays." It was during this period that Jeff eagerly embraced the marketing ploys of the credit card industry so that he could accumulate "miles" or "points" for frequent flier and consumer gift programs. More importantly, this practice led to "surfing" or transferring debt from high to low interest "introductory rate" credit cards.

As Jeff learned to “tread water” by “surfing” in this period, he learned the next lesson of the credit dependent: the “credit card shuffle.” That is, paying his credit card bills with other credit cards through monthly balance transfers and ‘courtesy checks.’ This acceptance of his new debtor status was “disheartening. . . but I rationalized it by telling myself that everyone else is in debt. . . Afterall, I’m going to get a great job and pay it off.” The “good” or “responsible” credit card debt such as school related expenses, a personal computer, and work suits was soon taken over by entertainment on weekends, restaurant dinners, spring break in Florida and then London and Canada. With one ten-day vacation costing over $5,000, “I even charged the passport application fee,” Jeff found himself on the verge of exhausting his available cash and credit. Fortunately, the university credit union is willing to assist students like Jeff whom find themselves “drowning in credit card debt. . . most of the people I know that go to the credit union are getting loans to pay their credit cards.” Without the option of federally guaranteed student loans to service his credit card debts, Jeff received a $10,000 loan at a moderate 11.9 percent. This credit union loan essentially “bought some time” for Jeff before entering the job market—an option not available to most college students. Not incidentally, a condition of the loan disbursement was that $3,000 had to be used to pay off one of his credit cards. The balance of the loan was spent on school expenses as well as catching up on his other monthly credit card payments.

During his junior year, Jeff began to engage in riskier and more creative credit card schemes. For instance, he began “surfing” which entails transferring debts from high interest rate cards to those with much lower albeit temporary ‘introductory’ rates. As Jeff learned how to lower his monthly payments through this technique, he began to exhaust his lines of credit. Instead of triggering cautionary warnings from his credit card companies, Jeff received new “Pre-Approved” credit card solicitations and congratulatory letters announcing that he had “earned” an increase in his credit limits. He even began receiving letters that encouraged him to miss a payment, such as during holiday gift-giving seasons, while lauding his good credit history. These mixed messages are easy for college students to misinterpret. Indeed, Jeff rationalized that his accumulating debt was not very serious since the the credit card companies “made it seem that everything was okay by sending new applications and raising existing credit limits.” During this period, moreover, Jeff became so dependent on ATMs (his parents *never* used them) that he did not even think about the transactional costs ($1.50–$3.00). As cash advances became more frequent, he did not want to know that the fees and higher interest rates made their cost comparable to short-term pawnshop loans. Eventually, he “hit the [financial] wall” when his meager stipend as a residence hall advisor made it difficult to send even minimum credit card payments. The $10,000 debt consolidation loan from the university credit union temporarily averted an economic crisis. But, this proved to be only a temporary financial “band-aid.”

Ironically, a contributing factorto his financial crisis was two failed business ventures with his roommate which were intended to eliminate their debts. The first was a service to translate resumes of Mexican and other Latin American students whom were seeking internships or applying to colleges in the United States. Encouraged by friends seeking their assistance, they purchased all the necessary office equipment of a high-tech company: computer, fax machine, cell phones, executive chairs, high quality business cards and fliers, web site fees, P.O. box, and legal fees for incorporation in Delaware. After several months without clients and rapidly depreciating business technology, Jeff and his “partner” opted to “cut our losses” and terminate the business. Each lost over $2,500. To add further financial insult, they had to pay additional legal fees to dissolve their corporation and are still paying the contract for their listing with an internet “search engine.”

Following this entrepreneurial debacle, they sought to recoup their losses through the stock market. Instead of becoming more cautious about debt, “our credit cards allowed us to get too big for our britches” According to Jeff, “my roommate found out that his company was going to be bought out. So, he was convinced that we would make a quick profit if we bought some stock before [the acquisition]. . . a sure winner! We each bought $5,000 worth of stock with cash advances from our credit cards. . . with e-trade we even saved on brokers’ commissions. . . The company was bought-out alright but then it was cannibalized and the stock fell. . . We each lost over $3,000.” When asked why they pursued such risky ventures while still in school, Jeff responded, “Because we could! The courtesy checks gave us the opportunity act on our impulses.”

By the end of Jeff’s junior year, the social empowerment provided by his 11 bank and 5 retail credit cards had changed dramatically: they had evolved from friends to foes. The social “doors” that they had previously “opened” were now increasingly closed. Jeff was “so concerned about meeting the right people and fitting in with them. . . . that [he] did not think twice about $50 bar tabs and spending spring break in London. . . . To think otherwise would have meant certain social death." Fortunately, Jeff was forced to confront his situation after realizing that "I no longer had control over my credit cards. Now, they controlled me." The earlier freedom to "act like an adult" had been replaced with the financial responsibility of paying for his earlier excesses. Indeed, rather than enjoying his final year at college, Jeff is enduring social hell by working full-time while taking a normal course load and applying/interviewing for jobs. He works at least 30 hours perweek at two part-time jobs (in addition to his position as a resident advisor) simply to make the minimum payments on his $20,000 credit card debt and $10,000 debt consolidation loan. Most of his friends have stopped calling to make plans for the weekend because he is "shackled to my credit cards. . . . I can't go out with them like I used to because I have to work. . . . ultimately, to pay for the fun that I charged on my credit cards a couple of years ago."

Today, Jeff views his credit cards with complete disdain, "I hate them." He is delinquent on many of his accounts and has threatened to declare bankruptcy unless the banks offer him more favorable interest rates. Ironically, Jeff's social odyssey of the last four years has brought him "full-circle" in affirming his father's mantra toward debt: "if you can't afford it, don't buy it." What angers him the most about credit card marketing campaigns on campus is that they extol the benefits of 'responsible use' but neglect to inform impressionable and inexperienced students about their "downside" such as the impact of poor credit reports on future loans and even prospective employment. This is crucial, according to Jeff, because he now understands that "the credit card industry knows exactly what it is doing [in encouraging debt] while taking advantage of students whom are trying to learn how to adjust to living away from home, often for the first time. . . . Let's face it, how can these banks justify giving me 11 credit cards on an annual income of only $9,000. These include a Gold American Express and several Platinum Visa cards."

Although Jeff does not dismiss his financial responsibility, he states that "I almost feel victimized. . . . giving credit cards to kids in college is like giving steroids to an athlete. Are you *not* going to use them after you get them?" Furthermore, as a dorm Resident Advisor (RA), Jeff emphasizes that the university offers an wide range of student informational programs and services but with one notable exception, "there if nowhere to go for debt counseling. . . . everything is discussed in Freshman Orientation or incorporated in Resident Advisor training and residence hall programs. . . . AIDS, suicide, eating disorders, alcohol, depression, peer pressure, sex ed, academic pressures, learning handicaps. . . . all but financial crisis management."

As Jeff has "gone full circle" in his attitudes toward credit cards, he is now coping with the unexpected "pain" of his past credit card excesses. Over $20,000 in credit card debt (plus his $10,000 debt consolidation loan and over$30,000 in student loans), Jeff has washed ashore from his "surfing" escapades. Although working two part-time jobs during his senior year, Jeff is now delinquent on several of his 16 credit cards. A business major, Jeff is anxiously awaiting the outcome of his job search. He is optimistic as some of his peers have already received starting salaries that range from $40,000 to $55,000 per year. In addition, several have received signing bonuses between $3,000 and $10,000. For Jeff, the latter is especially important because he plans to use this money to reduce his credit card debt.

Unfortunately, Jeff's promising career is encountering obstacles from an unexpected source—his credit cards. During a recent interview with a major Wall Street banking firm, Jeff was asked, "how can we feel comfortable about you managing large sums of our money when you have had such difficulty in handling your own [credit card] debts?" Jeff was stunned. It was obvious that the interviewer had reviewed his credit report—without prior notification—in evaluating Jeff's desirability to the firm. "Can you believe it," Jeff declared, "they want an explanation about my personal finances in college and yet they lost over $120 million last year!"

In their decision not to offer him employment, Jeff wonders how much was based on his GPA and how much on the "score" calculated by the consumer credit reporting agency. This is certainly not a potential consequence that is explained by the credit card industry when it exclaims, "Build your credit history. . . . you'll need [it] later for car, home or other loans." As Jeff passes by the MBNA Career Center on campus, which is named after the credit card company that he owes several thousand dollars, the irony of his "catch-22" situation is not lost on him, "how can I pay them back when their credit reports are hurting my chances of getting a good job!" It is not surprising that growing numbers of students like Jeff are increasingly using sexual analogies in describing their unforeseen circumstances. More bluntly, they are denouncing the predatory policies of the credit card industry as a form of "financial rape."

As Jeffs experience shows, student financial strategies are becoming increasingly complex as credit card companies offer "the [financial] freedom to hang ourselves." Even students at expensive private schools are finding ways to transfertheir credit card debt into supplementary loans without the knowledge of their parents. This increasingly popular practice helps to explain the wide vacillation in student credit card balances due to infusions of cash from other sources of loans. In addition, Jeff demonstrates how access to credit facilitates costly purchases that would not have been considered under the financial constraints of a typical student budget. The latter is especially disconcerting. It reflects the strong influences of escalating peer consumption pressures as well as sophisticated marketing campaigns that target the youth culture. One of the most seductive is the Sony advertisement, "Don't deny yourself. Indulge with the Sony [Visa] Card from Citibank. . . The official currency of playtime," Or, more succinctly, the ubiquitous NIKE slogan, "Just Do It." Although Jeff has so far avoided personal bankruptcy by securing a well-paying job with a commercial real estate developer, he notes with concern that some of his classmates have already been laid off due to the slowdown of the economy. In fact, some of his highest salaried classmates have become victims of the "reality check" that many dotcom companies are only recently confronting. If Jeff is forced into the ranks of the unemployed for an extensive period, he anguishes over the prospect that bankruptcy may be his most realistic option.

WHEN THE 'MAGIC OF PLASTIC' EXPIRES:

BANKRUPTCY IN THE AGE OF FINANCIAL IGNORANCE

Unlike Jeff, Cris has not been so fortunate in evading the dangerous financial shoals of consumer bankruptcy. This situation is especially surprising since her parents are both medical professionals with a combined household income of over $100,000. At the University of Maryland, Cris enjoyed the freedom of college life (with its promotion of a consumer lifestyle) which contrasted sharply with the harsh discipline of living at home. At the time, Cris' parents were oblivious to her new college lifestyle since she was limited to her meager savings from high school. Unbeknownst to them, however, the credit card industry was aggressively expanding into the previously ignored market of "starving students" in the late 1980s. For her father, it was ludicrous to think that major banks would give essentially unsecured loans to unemployed teenagers whom lacked experience in managing their economic affairs or discipline in controlling their consumption. Ironically, he was naive when it came to student finances and bank loan policies. Indeed, banks were eager to make high interest loans to students and credit cards became their financial 'vehicle' of choice. Ultimately, credit cards became the personal junk bonds of Generation X.

Cris' initial encounter with "plastic money" began early in the fall of 1989—her first semester of college. Citibank Visa advertisements "were plastered allover the university" and she thought that there was nothing to lose in submitting an application. Besides, Cris was curious about the "power of plastic" since her parents would not permit her to use a credit card in high school and she did not want to provoke an argument by asking now. Furthermore, all of her friends were receiving financial assistance for college from their parents and thus they had considerably more discretionary resources for "play." Emboldened by the prospect of financial independence, Cris eagerly filled-out the form which *did not require the consent of her parents*—only a copy of her student ID. At the time, Cris was 18 years old and working part-time at a telephone answering service for about $5.00 per hour. To her surprise, Citibank granted a $500 line of credit, which she immediately used to pay a large library fine and "buy a bunch of clothes at the mall that I couldn't otherwise afford." More importantly, Citibank's decision had a much more profound impact on Cris than the monetary value of its loan because, "it made me feel emotionally and financially mature. . . [The credit card] helped me *become* independent [in my relations] with my family and my friends. . . It made me realize that *I deserved to be responsible*. That i should not have to beg my stepfather for money or call my grandfather for [financial]] help."

Cris' new social and economic empowerment transformed her attitudes toward consumption and debt. No longer forced to "earn" the ability to consume through work related savings ('cognitive connect'), Visa also "liberated" her from the social control of her parents. At first, Cris limited her charges to school expenses and personal items. By the end of the academic year, Cris was routinely using her credit card for mall excursions, restaurant meals, bar tabs, concert and professional sports tickets, and weekend trips to the beach. These activities underscored Cris' newfound "freedom" and were reflected in her rising credit card debts. Indeed, the "power" of

Cris' first credit card convinced her to get a second by the end of the fall semester and two or three more in the spring. During this period, Cris learned the flip side of the "power of plastic:" the need to refuel its financial engine with monthly infusions of cash. By the second semester, Cris' top priority was maintaining her lifestyle and she began working full-time at the answering service company.

Not surprisingly, Cris' grades plummeted. For the first time in her life, she received a 'D' and an 'F' which resulted in academic probation from the university. As conflicts with Karl intensified over her social activities, Cris moved into an apartment with some of her college girlfriends. These additional financial pressures reinforced Cris' dependence on her credit cards. As her most dependent "asset," Cris saw them as both her personal "savior" and "best friend." When she needed economic help, they were always there for her. And, they did not ask questions about why she needed the money or moralize about her spending patterns. The only problem is that they are "high maintenance" friends with a small financial price to pay for their invaluable assistance. At least that was what Cris thought at the time.

Cris enjoyed a largely carefree summer and, to reduce her expenses, she enrolled in a local community college forthe fall semester. Already over $3,000 in debt and earning only $5.00 per hour, Cris was deluged with "Pre-approved" credit card offers. She attributes her desirability to the credit card industry by her prompt remittance of minimum monthly payments. During this period, Cris began to view her credit cards differently. "After spending my paycheck, I used my credit cards like savings. . . . I used them for everything . . . books, tuition, gas, food, hotel rooms at the beach. . . whether for school, emergencies or simply to enjoy an evening with friends." This intermingling of credit and earnings was reinforced by unexpected situations such as car repairs and medical emergencies. Afterall, she had to get her car fixed in order to drive to work and her health deserved immediate attention or she could not perform her job.

During this period, Cris began to engage in more creative and costly credit card practices that would foreshadow her eventual debt crisis. First, she began to regularly use her credit cards to generate additional cash flow. This strategy usually entailed charging all of her friends' meals at a restaurant and then collecting their money afterwards. Second, she began to routinely take cash advances from her credit cards "when I realized that I could." Initially, Cris would use cash advance checks to pay bills like rent, utilities, or car loan. As she got further into debt, however, Cris learned a sophisticated version of the "credit card shuffle." She would take cash advances at the end of the month and then deposit the money into her checking account so that she could send the minimum payments to the credit card companies. According to Cris, "it got to the point where I had written down all of the PIN numbers of my credit cards and, at the same ATM, I would take cash advances and then deposit the money directly into my [checking] account." Significantly, this financial management "system" was encouraged by her credit card companies whom profit from high interest rates, cash advance fees, and over limit penalties, "Every time I began to bump against my limit, the banks would raise them. [Because of this practice] it did not become a crisis early when I could have realized the seriousness of my situation." At the same time, market-ing inducements such as 10% off with a new retail credit card such as Hechts or a free Orioles bag with an application for an MBNA MasterCard were "too easy" to pass up.

Over the next two years, Cris' credit card debt jumped from about $5,000 to over $15,000. Cris marveled as she reflected on how she was unaware of the amount of debt that had accumulated on her 8 or 9 credit cards: "after being relatively stable for a couple of years it just [tripled] overnight." She moved back with her parents to reduce expenses which now included payments on a stereo, VCR, and TV. However, the recurrent conflicts with her stepfather ensured that this was only a short-term move. The following year, she moved in with her boyfriend. Although Cris had received a moderate raise to $6.50 per hour and earned as much overtime as possible, the economic burden of rent and utilities plus her car payment led to a sobering realization: her basic expenses exceeded her income. At the time, Cris had been content to send minimum payments on her credit cards because she had convinced herself that she would soon get "a good job and pay them all off." Instead, at 21 years old, Cris was forced to accept the reality that she would have to wcrk full-time and remain a part-time student while attempting to reduce her credit card debts. A $5000 debt consolidation loan offered only temporary relief.

As Cris slipped closer to her financial abyss, she was astounded by a debt counseling announcement that she saw on television. It explained that merely sending minimum payments would require over 30 years to pay off existing credit card balances. "With no end in sight," Cris' attitude toward her credit cards changed dramatically. From being her "best friend," they became her worst enemy—"I hated them." Dependent on the credit card shuffle to "simply get by," Cris sought help at a local debt counseling agency. What she received was a "shock. . . I thought that they could help anyone. . . instead, they told me that they could not help me at all. . . that I should declare bankruptcy. I was mad, they implied that I was beyond help. . . I had nowhere else to go. . . I could not believe that this was happening to me." Cris did not want to abandon her debts but, on the other hand, she could not find anyone whom was interested in helping her "put my life back together" unless she "started over again." In fact, the first bankruptcy lawyer that she consulted recommended that she "max-out" all of her credit cards before filing for bankruptcy. Cris was appalled by his suggestion. Afterall, she emphasized, "I am not irresponsible. I was not looking for an easy way out. . . He made me feel bad about myself and the whole [bankruptcy] process. . . I was doing it because there was no other option." Cris declined his offer to represent her during the bankruptcy proceedings.

In December 1994. at the age of 23, Cris' bankruptcy petition was approved. With the guidance of her attorney, which cost $695, the court discharged a total of $22,522 from 13 credit cards and a $5,000 consumer loan; she "reaffirmed" two credit cards and continued payments on her car loan. According to Cris, "I felt awful about abandoning my debt. Afterall, I tried to renegotiate through Debt Counselors but no one was interested in helping me renegotiate my debts." Indeed, the striking feature of Cris' story is her emphasis on individual responsibility while at the same time criticizing credit card companies for aggressively marketing excessive lines of credit to naive and emotionally vulnerable students, "I admit that I charged way too much. . . my debts were all my fault. . . [However] they should NEVER have given me all those credit cards at my age [under 22]. . . There was just too little effort to get them. The banks make it too easy to get into debt."

Fortunately for Cris, bankruptcy was a prudent decision because it enabled her "to put the pieces of my life back together." In fact, she was able to complete her junior college studies as a full-time student and is now enrolled to a four-year university. In May 2001, almost twelve years after receiving her first credit card, Cris is scheduled to graduate with a BA in accounting. For those whom contend that the consequences of bankruptcy are too lenient, Cris' experience is instructive. Although she agrees that the social stigma is diminishing, Cris emotionally responds that,

> "you don't know how bad [bankruptcy] is. They said [my bad credit] would last only 7 years but it will take ten years before the bankruptcy is erased from my credit report. . . I can't get a real credit card, AT&T just rejected me for their card, and forget about a house mortgage. . . I've talked to people who are thinking about declaring bankruptcy for only $4,000–$5,000 of debts. As little as they knew about credit cards, they know even less about bankruptcy. . . Kids need to understand the future repercussions of accumulating multiple credit cards. Many young people see only the immediate benefits/gratification. They are so [financially] ignorant. It is so sad."

'IT'S THE ECONOMY, STUPID'

SHUFFLING AND SURFING IN THE TURBULENT SEAS OF ECONOMIC UNCERTAINTY

Even students who eventually obtain steady, well-paying jobs after college graduation, the financial albatross of credit card debt may be insurmountable—especially those entering a less favorable job market. This increasingly common trend of employment disruption, which has been "regularized" through the enormous growth of temporary or "contingent" workers, has fundamentally changed the nature of employee loyalty and, in the process, created often unmanageable personal debt burdens. For a generation that has never witnessed an economic downturn, the perceived lack of an imperative to accumulate financial reserves (savings, lines of credit) suggests a potential social crisis when they must endure extended periods of un- and underemployment. The prospect of a potential recession in 2001, which belies the aggressive marketing of credit cards to college students, underscores the instructive experiences of "Daniel" whose graduation from college in the early 1990s resulted in unfulfilled expectations, disappointing job prospects, and insurmountable consumer debt obligations.

At the beginning of the employment life-cycle, "Daniel" illustrates how the impact of credit card debt acquired in college can be obscured by the middle class squeeze after graduation. That is, recent graduates tend to assume greater levels of consumer debt during their job search. This includes employment related expenses (resumes, business clothing, transportation) as well as personal living expenses (rent, food, car, entertainment). Significantly, recent graduates that are financing their lifestyle with credit cards are neither classified as students or new workers. It is during this transitional period that personal credit card debt often grows at a rapid rate—especially during a 'tight' labor market.

Daniel's unexpected odyssey into the financial depths of credit card debt began innocuously when he was offered a Citibank Visa application by a corporate representative while walking through the student center. A sophomore at a Howard University, he was struggling to pay for his college expenses and enjoy a modest social life in Washington, D.C. Daniel's middle-class, professional family is from Kenya and his goal was to become an accountant. With limited funds, Daniel was eager to receive "free money" but was skeptical that a major bank would give him a credit card since he was several years away from earning a middle class salary. From Daniel's perspective, an undergraduate college student is a major loan risk.

In 1988, however, Citibank was aggressively marketing credit cards to college students like Daniel whom it viewed as potentially lucrative customers for high interest, consumer loans. Citibank was so desperate to expand its credit card portfolio that it abandoned the industry policyof requiring parental co-signatures for unemployed students. Banks realized that they could "persuade" parents to pay for their children's credit card debts with threats of lawsuits and today "inform" parents of the disastrous consequences to their children's credit reports if their credit card debts are not repaid. By only requiring a copy of his university ID, Daniel quickly completed the application and received a $600 line of credit. He immediately used all of his "new money" for school books, food, and an occasional cash advance. At the time, Daniel thought that his "plastic cash" had been exhausted and he would have to survive on his previous "starving student" budget. Instead, to Daniel's surprise, he began receiving new credit cards in the mail—a peculiar reward for maxing-out his Citibank Visa. Over the next seven months, Daniel received Citibank MasterCard and Visa "Gold cards" with rapidly rising credit limits as well as several retail credit cards. For Daniel, it was amazing that all of these credit card applications were "pre-approved" before he had applied for his first job. Apparently, he thought, this reflected the banks' confidence in his future earning ability.

By the time Daniel finished his B.A. degree in 1990, he had over five thousand dollars in credit card debt. Although he does not remember most of these purchases, Daniel is grateful that his credit cards enabled him to enjoy a middle class lifestyle before he had a well-paying job. In fact, this consumer debt did not seriously concern Daniel because he was convinced that he would earn a good salary soon after completing his studies. This is why he justified the frequent payment of his consumer debts through cash advances and balance transfers from bank cards—the credit card "shuffle." Over the next two years, Daniel used students loans and credit cards to finance his Masters' degree in accounting. Upon graduating in fall 1991, Daniel had amassed over $15,000 in credit card debt. As a Certified Public Accountant (CPA), Daniel expected that he would be able to quickly payoff these high interest consumer debts. To his shock, however, the 1989 recession severely affected his employment prospects. Daniel spent the summer interviewing for jobs as an accountant and paid his living expenses with his credit cards. Although no longer a student but still looking for his first job, Daniel's credit card debts were approaching $20,000 when he took a "temporary" position as a security guard. Daniel was stunned that his first annual salary of approximately $15,000 was less than his total credit card debt

Even when a "good job" did not materialize, Daniel did not perceive his credit card debt as a serious problem. He was certain that it was simply a matter of time before he became financially solvent. Undeterred by his escalating consumer debt, Daniel's full-time job and extensive credit history enabled him to obtain even more credit and "buy whatever I wanted. In stores, I would apply for instant credit cards and be set to buy in a few minutes." Unfortunately for Daniel, his temporary position lasted nearly two years. As he explains, "During this time, I was basically surviving off credit cards. They paid my rents, entertainment, gas, and shopping..." In 1993, Daniel finally joined a Washington, D.C. firm as an accountant. As a CPA, his initial salary was over $50,000 and he believed that he could begin reducing his over $25,000 in credit card debt. However, Daniel's newfound professional success persuaded him to ignore his original goal of escaping credit dependence and he quickly accepted "pre-approved" offers for Chevy Chase Gold Visa, American Express, and Diner's Club cards. Emboldened by his new buying power, Daniel bought a condominium and furnished it with his credit cards. He rationalized the condominium as a good investment and, after all, the mortgage unlike his credit card debts is tax deductible. After a couple of salary increases, Daniel's rising standard of living soon included a new car and of course auto loan payments in 1994. Now Daniel felt like his hard work was being rewarded as a tax paying member of the American middle class.

By 1996, even with an annual salary of nearly $60,000, Daniel's credit card debts exceeded $30,000—and rising. According to Daniel, "My paycheck could only pay my condo, car, and credit cards. Then I had to depend on the credit cards for gas, groceries or anything else I wanted to buy. No savings. [Over] a few months, I would make thousands of dollars in credit card payment and the debts were not going anywhere.” Efforts to replace his high interest credit card debts with lower interest debt consolidation loans were time consuming and ultimately fruitless. Banks were reluctant to approve new consumer loans with such a high debt to income ratio. Reluctantly, Daniel believed that he had no other option but to file for personal bankruptcy. In early 1997, his Chapter 7 filing was approved by the D.C. bankruptcy court and all of his credit card debts were discharged.

Today, Daniel is recovering from the personal pain of bankruptcy and thankful for the opportunity to rebuild his financial future. “Without it [bankruptcy], I would still be increasing my credit card debt and they [banks] would still be increasing my credit limits. . . instead of relying on cash [advances] from my credit cards I can now get cash from my savings account.” Daniel still uses “plastic” but only for convenience and “prestige.” That is, to minimize suspicions about his past financial problems; he has a debit card and a ‘secured’ Visa credit card. The credit line on his collateralized secured card has been raised twice and Daniel hopes that he will be approved soon for a retail credit card following two previous rejections. Although the days of “easy credit” are temporarily over, Daniel knows that it is only a matter of time before he is able to rejoin the ranks of the middle class with the full privileges of a Gold credit card.You know office politics.” In sum, a review of Daniel’s bankruptcy petition portrays a well-paid professional who appears to have been unable to control his consumption desires. In reality, however, about two-thirds of his credit card debt was accumulated during college and his initial job search. Hence, the roots of Daniel’s financial insolvency were sown by his credit dependency as a university student and the unforeseen difficulty in obtaining a job in the aftermath of the 1989 recession.

THE ARRIVAL OF THE ‘MAGIC OF PLASTIC’ IN THE GOLDEN YEARS:

PATCHING THE SOCIAL SAFETY-NET OF ELDERLY SURVIVAL

Among America’s senior citizens, the credit card industry has encountered the most formidable challenge to its promotion of easy credit.[4] The debt abhorrent behavior of the parents and grandparents of America’s Baby Boomers was profoundly shaped by their personal experiences during the Great Depression. Today, however, many seniors are confronting formidable economic realities that are challenging their longstanding attitudes toward “easy” consumer credit. The fact that the credit card industry began aggressively marketing its products to senior citizens in the late 1980s, including lucrative agreements with the American Association of Retired Persons (AARP), illuminates the intense resistance of these generations to the social shame of personal debt. Not surprisingly, according to the 1995 Survey of Consumer Finances, older Americans are the least likely to revolve debt on their credit cards. In answering ‘yes’ to the question, “Do You Almost Always Pay Off Your Credit Card Balance,” the response by age of respondent is revealing: under 35 years old (40.2%), 35–44 (40.7%), 45–54 (47.1 %), 55–64 (59.3%), 65–74 (72.0%), and 75 and older (85.8%). And yet, with stagnant retirement incomes and rising rent and medical costs, credit cards increasing are becoming the financial glue of the crumbling social safety-net of America’s senior citizens. This sudden receptivity reflects both industry policies (reluctance to give conventional, low-interest ioans to retirees and aggressive credit card marketing campaigns) as well as the growing desperation and socialisolation of the elderly—especially widows. This trend is illustrated by 78 year old Jeannie May Lawson.

Jeannie May has worked hard, all of her life, to raise three children and generally to “just get by.” Divorced for over 40 years, she survives on asocial security check of $648 per month and part-time work in the “old folks home” where she lives in a small town in upstate Illinois; the rent for her subsidized, one-bedroom apartment is $196 per month. Unlike many of her generational peers, Lawson lacks an accumulated “nest egg” for retirement. Her low-income, blue-collar jobs did not offer a private pension and divorce deprived her of the opportunity for greater household savings. More importantly, the modest home that she and her husband purchased with a VA loan after The War, was sold years ago. This seemingly uneventful decision has had a major, unforeseen impact on Lawson’s “Golden Years.” That is, home equity is the most important source of personal wealth for retirement, especially among working class families. Today, nearly four out of five (79.1 %) seniors over 64 years old are home owners and only 8 percent are still paying on their first mort-

[4] For an extended discussion of credit card use among senior citizens, see Robert D. Manning, “Aging Into Debt” in *Credit Card Nation* (Basic Books: 2000).

gages while 28 percent have various home equity and second mortgages. Not surprisingly, home equity accounts for most assets of older adults.

Jeannie May symbolizes the plight of America's working class elderly. Born in 1915, the United States was still a largely rural society—especially in the Midwest—when she was growing Lap in northern Illinois. The youngest of five children, her parents worked the small family farm that produced mostly corn, and some vegetables for the market as well as pigs, cows, and chickens primarily for household consumption. Money was scarce as the family, second-generation immigrants from England, struggled to make ends meet in a local farm economy where credit was informally negotiated and debts were commonly satisfied through bartered exchanges. For example, the local dentist was frequently paid for his services "in-kind" with eggs, butter, and freshly dressed chickens while the school teacher received food and housing which was supplemented with a small monetary salary. This practice of non-monetary exchange was especially common during the 1930s when Lawson's most vivid memories concerning credit and debt were molded. "Moneywas hard to come by in those days. . . . many people were losing their farms and even their homes. . . . it was tough times."

Jeannie May's rural life experiences, Calvinist religious upbringing, and recollections of the Great Depression profoundly shaped her attitudes toward personal debt. On the one hand, the economic rhythms of the seasonal farm economy required rural families to rely on credit for agricultural and household supplies during the planting and fallow seasons and then repay their debts after harvesting the corn or selling some livestock in the cash economy. Hence, even among yeoman farmers, credit and debt were "natural" features of their modest lifestyle. On the other hand, the local Protestant churches emphasized the Calvinist values of hard work and frugality as evidence of a virtuous life. This emphasis on savings as a "sign" of potential spiritual salvation contrasts sharply with the negative views toward leisure activities and personal consumption. Lawson remembers sermons in the little white church that chastised "idle hands" and indolent "material desires" as moral sins that would lead to disastrous personal debt. Together with the painful experiences of the Great Depression, when friends and family members "lost everything to the banks," Lawson entered her "golden years" with very conservative attitudes toward credit and debt.

At 78 years old, Jeannie May still enjoys an active lifestyle that belies her age. Unlike her affluent brother, John, she was unable to translate the generational advantages of rising wages, inexpensive housing, and low educational costs into economic security in retirement. This is partially due to Jeannie May's divorce and inability to re-marry which forced her to assume the economic responsibility of raising her three children on a single income. Although national poverty rates among older adults at least 65 years old have been falling over the last two decades, from 15.7 percent in 1980 to 10.8 percent in 1996, older women are nearly twice as likely as older men to live in poverty. Also, African American and Latino seniors are nearly three time as likely as Whites to live in poverty; Asian and Pacific Islander rates are nearly the same as Whites (9.7 versus 9.4%).

For Lawson, her fragile financial circumstances mean that she can not enjoy a leisurely life in her final years; she would prefer to catch up on her "patchin' [a quilt] or kniftin' [an Afghan]" for a newborn nephew or niece. Instead, when her health permits (she has diabetes and high blood pressure), Jeannie May works 15 to 30 hours per week in the "[retirement] home's" kitchen as well as housework and errands for "neighbors" who are usually several years younger. Lawson's experience, of course, is not unusual. The U.S. Census Bureau reports that 8.6 percent of women and 17.1 percent of men over 64 years old are still "officially" employed in 1997, with projected increases in 2006 to 8.7 percent for senior women and 17.8 percent for senior men. Significantly, this rate for men has declined from 19.0 percent in 1980 whereas it has risen from 8.1 percent for women. 15 Although Lawson occasionally receives small financial gifts from a son in Seattle, her older brother is the only source of economic assistance that she can depend on in case of an emergency. That is, until the day that she received that miraculous piece of plastic in the mail—her secret financial savior.

Jeannie May does not recall the first VISA solicitation that arrived in late 1987. What she does remember is her excitement over the financial "freedom" that it offered. Afterall, as a struggling single mother, Lawson was always grateful for the higher standard of living that installment credit had provided for her and the children in the 1940s and 1950s. TheVA home mortgage loan, used car loans from finance companies, corporate loans for appliances and furniture, store credit from local merchants for clothing, and a charge card for gasoline. Lawson confides that she rarely paid off the balance of her credit accounts at the end of the month and was often late with her payments. Although she accepts most of the responsibility as a poor "budget keeper," she laments that her ex-husband's irregular child support increased her dependence on consumer credit by "stretching" her meager earnings.

Unlike her past experience with proprietary credit cards (Sears, Montgomery Ward), the new "universal" VISA card offered herthe "magic" of purchasing items nearly anywhere she wanted and whenever she wanted them: local merchants, mail order, and even over the telephone. More importantly, it enabled Lawson to the avoid the scrutiny of her financially secure brother (a successful dentist) and his condescend ing wife who frequently criticized Jeannie's lifestyle when "helping" with her financial crises. Hence, by avoiding such embarrassing financial assistance, Jeannie May did not have to confront the Calvinist guilt that would eventually erupt from her escalating mountain of consumer debt. This attitudinal denial was reinforced by the marketing strategies of the the credit card industry. As long as she "paid her minimums [monthly credit card payments]," Jeannie May convinced herself that she was satisfying her financial obligations and thus adhering to her generation's moral code of conduct.

Unaware of the technological advances in mass marketing, Lawson was flattered by the personalized "invitations" for bank cards that arrived in her mailbox. Jeannie's limited education (she did not complete high school), low self-esteem (modest family background), meager income as a divorced, blue-collar worker ("scarred" credit history), and respect of authority figures (bankers), made her especially susceptible to the marketing ploys that affirmed her self-worth as a "valued" client. Even after violating her own Calvinist values and life experiences during the Great Depression, by. consuming more than she could afford, Jeannie willing accepted the banks' explanation that she was credit worthy and that she "deserved" to be "rewarded" with a higher line of credit. After all, she did what she was told, at least for the first few years: promptly remit the minimum payment at the end of each month. As Lawson recounts,

> "I never really looked at the credit card bills much. What was important [to me] was what I had to pay at the end of the month. . . I didn't really keep track of how much I owed. I paid 'em what they wanted [minimum payment]. They were happy and I was happy."

What is striking and especially disturbing about Jeannie May's experience is the ease of manipulating her to assume debt levels that she was incapable of financing much less eventually able to pay-off. Indeed, the predatory marketing strategies of the credit card companies are very effective in exploiting the low self-esteem and falling standard of living of America's senior citizens. As a divorcee who never remarried, for example, Jeannie May's material lifestyle had plunged below that of her brother and even her children—especially after her retirement. Although she accepted the Calvinist ethos of hard work and frugality, Lawson yearned for some of the indulgences that members of the middle class take for granted: vacation trips, new cars, household furniture, restaurant outings, gift-giving, and even chocolate candies. With few friends (most deceased or in nursing homes) and a disconnected extended family (children in Seattle, Milwaukee, New York), she began coping with her loneliness by embracing material rewards during her leisure time. In the process, Jeannie May sought to emulate the consumption privileges of many middle-class wives (such as her sister-in-law), whom balanced their husbands' economic success as "producers" by being the primary household "consumers."16 It was through the magic of Jeannie May's piece(s) of plastic that she was able to finally enjoy a comfortable life that previously had been withheld from her.

For Lawson and millions of elderly citizens, credit cards are serving increasingly important purposes during the current era of fragmented families and an increasingly fractured social-welfare system. Indeed, Jeannie May did not use her credit cards frivolously by middle class standards, at least at the beginning. The car needed repairs and new tires, her automobile insurance premiums were raised, her diabetes and high blood pressure medications were more costly, she replaced her reading glasses, and finally bought anew winter coat. Lawson's newfound purchasing power also unleased the ability to satisfy other "wants" that she felt had been unfairly denied. This led to such purchases as a sofa and dining room table for her apartment, a set of pots and pans for the kitchen, new clothes, knitting and sewing materials/supplies, restaurant dinners, and small gifts for family members during the holiday season.

Although supermarkets did not initially accept credit cards, she charged groceries and household supplies at drug stores and even mail-order steaks (delivered by dry ice) from Nebraska. Later, Lawson began making purchases over the telephone via the Home Shopping Network. Jeannie May described with irrepressible glee her anticipation of the UPS truck as it made its appointed deliveries of her eagerly await-ed "surprises." For Lawson, the magic of plastic offered the opportunity to enjoy the consumer lifestyle promoted by mass advertising yet denied by Social Security.

By the time Jeannie had maxed out her first credit card in late 1988, about $3,000 in less than a year, she truly believed the banks' form letters that extolled her responsible credit history. In fact, she began to accept the "pre-approved" credit card solicitations that arrived in her mail box with the now familiar logos of VISA and MASTERCARD, as these were not just any banks that were "callin' on her." Esteemed financial institutions such as Citibank, First Chicago, Continental Bank, and Chase Manhattan were actually vying for *her* business. According to Lawson, "I figured if the banks keep on sending 'em to me, then I figured I'd keep on usin' em. . . [Afterall] they're in the business of lending money. I. trusted 'em. I thought they knew what they were doing." And they did. Instead of eliciting a financial warning after reaching her credit card limit, Jeannie's "mature" account status triggered a second and then a third card in 1989 followed by a fourth credit card in early 1990. By 1991, Lawson had a huge credit card debt and was having difficulty "making all my [minimum] payments."

Jeannie May really did not know how much debt she had accumulated (over $12,000) or even how bad her financial situation was at the time. What she did admit was that the infirmities of old age were finally catching up to her. "I never thought of myself as one of the old folks [in the retirement home]. . . I could get around on my own and even helped them with their own chores. With my car and job, my life really hadn't changed much [in retirement]. . . I just didn't have to work as hard [at a full-time job]." The reality, however, was that she could not live adequately on her Social Security income—even with participation in public programs for the elderly such as subsidized housing and medical care. As a result, it became increasingly difficult to budget her modest monthly income due to rising health-related expenses and an uncertain level of supplementary earnings. On the one hand, her high blood pressure and diabetes required more costly medicines—even with Medicaid assistance—which increased her need to work. On the other, her poor health meant that she could not work regularly at "the home" and thus could not rely on extra earnings to supplement her meager Social Security check. Although Jeannie's children remain in contact with her, they provide little financial help; occasionally they send money, but it amounts to only a "couple a hundred dollars a year." Hence, with a limited family support system and America's shrinking social safety-net, Lawson's credit cards became her most reliable form of assistance against the unforeseen and debilitating exigencies of the aging process.

it was primarily for economic reasons that Jeannie May ignored her doctor's advice to "slow down" and stubbornly continued to work part-time. For Lawson, employment was crucial to maintaining her newfound independence. That is, work enabled her to shield the escalating credit card debt from outside scrutiny while continuing to enjoy her relatively comfortable lifestyle. Unfortunately, the combination of financial duress, failing health, and a long life of arduous manual labor finally culminated in a mild stroke at the end of 1991. Already stretched to her financial limit, the temporary end of her part-time job forced Jeannie May to finally confront the reality that she could no longer make the minimum payments on her credit cards. While convalescing at home, moreover, the tone of her credit card statements shifted radically—from friendly to concerned and then to threatening. It was at this time time that Lawson desperately sought help from the source of last resort: her brother. And, she knew that this decision would require a humiliating explanation as well as the end of her credit reliant lifestyle. For Jeannie, her Calvinist guilt and personal shame would soon be supplanted with the punishment of her previously spartan lifestyle.

Lawson's brother, John, remembers the phone call that led to his dismay over the predicament of his sibling. John lived in a posh, northside suburb of Chicago and immediately made the three-hour drive to Jeannie's apartment. He had always been protective of his youngest sister and was surprised by her agitation over what he assumed was a relatively minor problem. Afterall, she was a frugal person and there were no obvious warning signals to indicate a sudden change in her lifestyle. In fact, John was unaware that Jeannie May had *any* bank cards. Upon reviewing her credit card charges, he found not one but four separate accounts. Furthermore, John was able to reconstruct her consumption patterns. What were normal and modest purchases for him were often unnecessary or too costly for Jeannie. Even so, John was impressed by the general pattern of essential charges: car repairs, gasoline, medicine, groceries, clothes, insurance, and other necessary household items.

After compiling all of Lawson's outstanding credit card bills, John was shocked by what they revealed. In less than five years, Jeannie May had amassed over $12,000 in consumerdebt. Fear and shame had led her to ignore the cumulative outstanding balance while the marketing campaigns of the credit card industry continued to persuade Lawson that she was a "good" customer. For Jeannie May, her elevation to a middle class standard of living proved to be a temporary respite. After paying the rent, Lawson's Social Security check barely covered the minimum payments of her credit card accounts. Clearly, if she ever was to regain economic self-sufficiency, Jeannie May had to escape from this financial albatross and return to her more modest lifestyle. With the help of John's lawyer, Jeannie May filed for personal bankruptcy and is no longer responsible for her past credit card debts. In addition, John purchased a small annuity that supplements Lawson's retirement income (about $200/month) for the rest of her life. Although a compassionate and foresightful act, John's recent death of a heart attack at age 87 means that Jeannie May has lost her only dependable source of economic assistance. For her and increasing numbers of the impoverished elderly, the ability to secure a bank credit card is the most realistic strategy for obtaining a modicum of financial security in their later years. And, this is not an unlikely prospect in view of the intensifying competition by credit card companies over new accounts of revolvers.

CONSUMER DEBT:

INDIVIDUAL VERSUS INSTITUTIONAL RESPONSIBILITY

In conclusion, the economic expansion of the last decade was not as strong as described by leading economic indicators due to bank lending policies that promoted inflated consumer expectations through easy access to high cost consumer loans whose interest rates far exceed the pace of household income growth. Similarly, the economic indicators do not necessarily imply a consumer-led recession if the leading financial services conglomerates like Citigroup, Bank of America, and J.P. Morgan Chase do not overreact to the abrupt decline in national economic growth. The concern is that these financial services corporations may "tighten" their lending policies for small businesses (primary generator of U.S. jobs) and heavily indebted families that previously were considered acceptable credit risks. This may not only limit future levels of business investment and household consumption—which would exacerbate the downward spiral in macro-economic growth—but it may also force tens of thousands of financially distressed households into personal bankruptcy due to unforeseen events. As the most comprehensive analysis of consumer bankruptcy in the early 1990s shows,[5] most filings are attributed to unforeseen events (job loss, health/medical expenses, divorce) rather than excessive consumer spending patterns. Surprisingly, the consumer financial services industry has responded by reducing its "fair share" contributions to nonprofit consumer credit counseling organizations at the same time that the demand for these services is rapidly escalating. Like replacing small business loans with high interest credit cards, the question is whether the financial services industry is truly committed to reducing the national rate of consumer bankruptcies by supporting institutionally responsible policies that balance the often unrealistic consumption desires of American households.

With the renewed efforts of the financial services industry to enact more stringent personal bankruptcy laws, bankers could exacerbate a national economic slowdown by forcing financially insolvent households to continue paying off a portion of their consumer debt—years after filing for personal bankruptcy. This is certainly not a propitious time for enacting such a painful and often devastating policy on some of America's most vulnerable households. Indeed, legislative proposals tend to reflect an societal context of rapid economic growth rather than a sudden and unexpected economic slowdown. The U.S. economy needs greater stimulation through increased consumer demand rather than curtailing the future buying power of a large segment of the U.S. population.

The industry's call for greater individual responsibility belies its disregard for its own traditional underwriting criteria. For example, grandparents with stellar past job histories are often rejected for credit cards while their grandchildren who have never had a full-time job are inundated with solicitations while in college. Similarly, recent colleges students may be rejected for credit cards after graduation when their entry-level salaries suggest an inability to service higher levels of debts. Indeed, a striking finding of my study of college student credit card debt is that recent graduates of the late 1980s and early 1990s were more likely to assume most of their credit card debtwhile seeking gainful employment than while enrolled in college. Today, college students routinely graduate with credit card debts of from $5,000 to $15,000 plus student loans before they enter the job market. With the specter of a tight job market in the near future and the continued corporate promotion of in-

[5] Teresa Sullivan, Elizabeth Warren, and Jay L. Westbrook, The Fragile Middle Class: Americans in Debt (Yale University Press, 2000).

flated consumer expectations, it can be expected that the bankruptcy rate of recent college graduates will continue to soarwith potentially disastrous long-term consequences. Indeed, the faster growing group of bankruptcy filers last year were individuals 25 years old or younger.

Clearly, the recent assumption of tremendous levels of consumer debt—provided by financial services institutions that have routinely ignored their traditional underwriting criteria—requires accountability and financial responsibility from both sides: borrowers and lenders. Indeed, lending policies that routinely require the poor and heavily indebted to subsidize the low and even free cost of credit card loans to the affluent through escalating interest rates and penalty fees, does not reflect an appropriate policy of shared individual and institutional responsibility. In fact, increasing the financial obligations of filers to their creditors after bankruptcy would encourage banks to continue extending "easy" credit to those least able to assume their financial responsibilities during a period of economic uncertainty and distress. Banks and other financial services institutions should share the pain as well as the gain associated with the liberal extension high cost, consumer credit. Otherwise, consumer lending policies of financial services institutions may continue to discourage the promulgation of prudent and responsible underwriting policies. It is my hope that the final form of this legislation will promote personal responsibility as well as corporate accountability. Thank for you for this opportunity to present the implications of my research before the Committee prior to its deliberations on this legislation which will impact millions of vulnerable citizens.

ROBERT D. MANNING, PH.D.
Institute for Higher Education Law and Governance
University of Houston Law Center

Senator SESSIONS. Mr. Dean Sheaffer is the Vice President and Director of Credit for Boscov's Department Stores, in Laureldale, Pennsylvania.

Mr. Sheaffer?

STATEMENT OF DEAN SHEAFFER, VICE PRESIDENT, DIRECTOR OF CREDIT, BOSCOV'S DEPARTMENT STORES, INC., LAURELDALE, PENNSYLVANIA

Mr. SHEAFFER. Thank you very much. Good morning. My name is Dean Sheaffer. I am Vice President and Director of Credit for Boscov's Department Stores. Boscov's is a family owned Mid-Atlantic chain with stores in Maryland, New Jersey, two stores in Delaware, three 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 the Chairman for providing me with the opportunity to testify before this distinguished committee.

Between 1995 and 1999, national bankruptcy filings rose more than 60 percent. Last year, there were nearly 1.25 million bankruptcy filings. At Boscov's, we have significantly tightened our credit standards. Between 1996 and 2000, we closed, reduced the credit limit, or took other preemptive action on nearly 41,000 accounts, in direct response to increased bankruptcies.

Despite these actions, Boscov's combined January and February 2001 bankruptcy write-off will be more than 40 percent higher than January and February of last year. Part of the problem is that higher-income people who do not really need Chapter 7 relief are using that chapter to wipe out all of their debts. These people are not on the margin.

Our response, tightening credit, is a very blunt instrument. It does hurt the people who are at the margin—the young, the old, the low- to moderate-income. It limits their access to credit, but it does not get at the higher-income individuals who are filing bankruptcies of convenience.

Mr. Chairman, I would like to put these numbers in perspective. If the current rate of filings holds, within the next decade one in every seven American households will have filed for bankruptcy. The system is seriously flawed. It is estimated that over $40 billion was written off in bankruptcy losses last year, which amounts to the discharge of at least $110 million every single day. This money does not simply disappear. Last year, to make up for these losses, it cost each of our households several hundred dollars. Estimates suggest this year's numbers will be 10 percent higher, and next year's filings yet another 20 percent higher.

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, such as catastrophic accident, illness, divorce, or job loss, from which they cannot otherwise recover.

Finally, most people who file for bankruptcy do need relief. We must be very careful to distinguish the average filer who uses the system properly from the smaller but significant group of others who misuse the system for their benefit.

For many years, we tracked the payment history of those of our customers who use the Boscov's card. The vast majority of our customers pay as agreed. In the past, however, we could occasionally see a customer who might fall behind a few months, make payments to catch up, fall behind again, attempt to recover, and so forth. We monitored these accounts and intervened as necessary, perhaps by suggesting consumer credit counseling or by limiting their credit to minimize the damage.

Today, however, we see a very different picture. Often, the first indication we receive than an individual is experiencing financial difficulty is when we receive their notice of bankruptcy petition. In a 1998–99 study at Boscov's, almost half of the bankruptcy petitions we received were from customers who were not seriously delinquent at the time they made the decision to file bankruptcy. It appears that bankruptcy is increasingly becoming a first step rather than a last resort.

Senator BIDEN. Could you repeat that again? I am sorry. I am not sure I understood what you just said about those who filed were not seriously——

Mr. SHEAFFER. When they made the decision to file bankruptcy, their account at Boscov's was not seriously delinquent.

Senator FEINSTEIN. Was not seriously——

Senator BIDEN. Delinquent.

Mr. SHEAFFER. Delinquent, past due.

Senator BIDEN. In other words, they were not in trouble yet at Boscov's.

Mr. SHEAFFER. Right.

In today's law, individuals have a choice as to whether to file in Chapter 7, which generally wipes out all their unsecured debts, or to file in Chapter 13. Instead of wiping out everything, a Chapter 13 filer attempts to pay as much as her or she can afford and then the court discharges the rest.

Not surprisingly, most people file in Chapter 7, but many people who are filing in Chapter 7 do have the ability to pay some or all of what they owe. I understand that various studies have pegged this number at anywhere from 30,000 filers per year to nearly a quarter of a million.

Why are so many persons asking the court to make others pay for their debts? Part of it is lawyer advertising. We have all seen the ads on TV by lawyers promising to make individual's debts disappear. Some do not even mention bankruptcy; they talk about restructuring of finances. I question whether these aggressive advertisers inform their clients about the serious downsides of filing bankruptcy. I also believe part of the problem is the declining social stigma associated with filing for bankruptcy.

Finally, these changes have revealed a flaw in the system itself. Our Bankruptcy Code allows individuals to choose the chapter they wish to file in, regardless of need. If shame will not keep the subgroup of filers who could pay from either filing or from filing on the wrong chapter, Congress must establish a mechanism that will, and that is simple, fair and efficient.

In 1998, 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. But for that subgroup of filers, for those higher-income individuals who would abuse Chapter 7, the needs-based test would have said no, pay what you can afford, then society will wipe out the rest.

Last year, we supported the conference report that passed both the Senate and the House, but died while Congress was out of session. We continue to support both S. 220 and H.R. 333, which are identical to last year's conference report. However, we are deeply concerned that if these heavily negotiated bills are further watered down, the intended benefits are lost.

We are also deeply concerned that some wish to attach amendments regarding essentially unrelated issues. While these issues may be important, they should stand on their own merit. In the context of bankruptcy, their primary effect is to derail the critical, needed changes to bankruptcy law.

In closing, I want to say that we offer credit to help our customers purchase merchandise. In fiscal year 2000, we received thousands of bankruptcy petitions amounting to $3.5 million. For a retailer our size, that cannot continue.

On behalf of the National Retail Federation, we urge Members of Congress to swiftly pass legislation to address the problems confronting the Nation's bankruptcy system in the form of S. 220 without amendment. 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.

Thank you very much.

Chairman HATCH. Thank you.

[The prepared statement of Mr. Sheaffer follows:]

STATEMENT OF DEAN SHEAFFER, VICE PRESIDENT, DIRECTOR OF CREDIT, BOSCOV'S DEPARTMENT STORES, INC., LAURELDALE, PENNSYLVANIA

Good Morning. My name is Dean Sheaffer. I am Vice President and Director of Credit 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 the Chairman 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 2000 sale (2000 sales of $3.1 trillion. NRF's members and the consumers to whom they sell are greatly affected by the recent surge in consumer bankruptcies.

Bankruptcies are still out of control. Between 1995 and 1999, national filings rose more than sixty percent (60%). In Pennsylvania where we are based, Chapter 7 bankruptcies grew by 90 percent in that same time period. Nationally, filings continue to exceed the one million filing record set in 1996. Last year there were nearly 1¼ million bankruptcy filings, the overwhelming majority of which (more than 95 percent) were consumer filings. and the latest trends are up dramatically.

At Boscov's, we have—credit. Between 1996 and 2000 we closed or reduced the credit limit or took other pre-emptive action on almost 41,000 accounts in direct response to increased bankruptcies. Many of those people would have been good customers, but we had to restrict their access to credit because that is the only tool at our disposal. We did not want to do it. And yet despite these hesitations, if the current trend continued, Boscov's combined January and February 2001 bankruptcy write off will be more than 40% higher than January and February of last year.

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-it limits 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 would like to put these numbers in perspective. Bankruptcy filings are more than triple now than they were during the much worse economic conditions that existed in the 1980's. If the current rate of filings holds within the next decade, 1 in every 7 American households will have filed for bankruptcy. The system is seriously flawed.

It is estimated that over $40 billion was written off in bankruptcy losses last year, which amounts to the discharge of at least $110 million every day. 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 thousand 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. The nation's 100 million households ultimately pay that $40 to $50 billion. Last year, to make up for these losses, it cost each of our households several hundred dollars. Estimates suggest this year's number will be 10% higher and next years filings another 20% higher. If these bear out, bankruptcy will truly be out of control.

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. 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 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 other who urge individuals to use bankruptcy to "beat the system." Whatever the cause, it must be stopped.

My experience at Boscov's, and that of credit managers at other stores with whom I have spoken, convinces me of this fact. 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, however, we would occasionally see customers whose payment patters were more erratic. They might fall behind by a few months, make payments to catch up, fall behind again, attempt to recover, and so forth. This kind of payment history suggested to us that the customer was experiencing some sort of financial difficulty. We would monitor the account and intervene as necessary, perhaps by suggesting consumer credit counseling or by limiting their 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 receive that an individual is experiencing financial difficulty is when we receive notice of his bankruptcy petition. In a 1998/1999 study at Boscov's, almost half of the bankruptcy petitions we receive were from customers who are not seriously delinquent with their accounts. The first indication of a problem is the notice that they have filed for bankruptcy. It appears that bankruptcy is increasingly becoming a first step rather than a last resort.

Individuals 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 filing reflect this. Professor Michael Staten at Georgetown University analyzed thousands of Chapter 7 petitions in courts all over the country. His review of debtors' own financial statements gives a strong indication of what is going wrong.

Individuals have a choice as to whether to file in Chapter 7, which generally wipes out all their unsecured debts, or to file in Chapter 13, often known as a wage-earner plan. Instead of wiping out everything, a Chapter 13 filer attempts to pay as much as he or she can afford and the court discharges the rest. Not surprisingly, most people choose to file in Chapter 7.

But many people who are filing in Chapter 7 do have the ability to pay some or all of what they owe. I understand that various studies have pegged this number as being anywhere from 30,000 filers per year to eight time that number. Whatever the figure, we should not treat bankruptcy as a "get out of debt free" card that can be used by tens of thousands of filers every month, with virtually no questions asked.

Why are so many persons asking the court to make others pay their debts for them? Why aren't they ashamed to go into bankruptcy court? We think that there are a number of factors.

Part of it is 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" you 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 costs "bankruptcy mills" are part of the problem.

I also believe that part of the problem is the declining social stigma associated with filing for bankruptcy. 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 and their car. They seem to have access to credit (although in many cases whet they actually line"). And their friends and neighbors, not seeing the details of their life that bankruptcy disrupts, assume that bankruptcy is not the devastating situation they always thought. There have also been a number of high profile celebrity bankruptcies in recent years. I cannot help but think that this sends a message tot he public that the stigma of bankruptcy is fast disappearing.

Finally, these changes have revealed a flaw in the system itself. Out bankruptcy code allows individuals to choose the chapter they wish to file in, regardless of need. If shame will not keep the subgroup of filers who could pay from either filing, or from filing in the wrong chapter, Congress needs to establish a mechanism that will. It must be simple, fair and efficient.

In 1998, 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 would use Chapter 7 to push their debts onto other regardless of the filer's ability to pay, the up front, needs-based test would have said, "No. Pay what you can afford, and society will wipe out the rest." Last year we supported the conference report that passed both the Senate and House, but died while Congress was out of session. We continue to support the both S. 220 and H.R. 333 which are identical to last years' conference report. However, we are deeply concerned that if these heavily negotiated bills are further "watered down" the intended benefits will be lost. We are also deeply concerned that some wish to attach amendments regarding essentially unrelated issues. While these issues may bear important, they should stand on their own merit. In the context of bankruptcy their primary effect is to derail the critical, needed changes to Bankruptcy law.

In closing, I want to say that we offer credit to help our customers purchase our merchandise. Out typical retail balances are not large, but we have lots of customers. In fiscal year 2000 we received thousands of bankruptcy petitions amounting to 3½ million dollars. For a retailer of our size, that cannot continue. On behalf of the National Retail Federation, we 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 in the form of S. 220 without amendment, now.

Chairman HATCH. Ms. Vullo?

STATEMENT OF MARIA T. VULLO, PARTNER, PAUL, WEISS, RIFKIND, WHARTON AND GARRISON, NEW YORK, NEW YORK

Ms. VULLO. Thank you, Mr. Chairman and Senator Leahy and Senator Schumer, for inviting me to appear before this committee today. My name is Maria Vullo and I am a partner with the law firm of Paul, Weiss, Rifkind, Wharton and Garrison. I was the lead counsel for the plaintiffs in the case in Portland, Oregon, in which a jury rendered a $100 million verdict against anti-choice extremists who had threatened my clients' lives.

I am here in support of the Schumer-Leahy amendment to the Bankruptcy Code which would make violence and threats of violence against family planning clinics non-dischargeable in bankruptcy. This amendment is needed to prevent further abuse of the bankruptcy system.

Senator Sessions mentioned before Mobile, Alabama, and Pensacola, Florida, on a different issue. But what is significant, in my view, about those two locations is that an abortion doctor was killed in Mobile, Alabama, and two were killed in Pensacola, Florida, in 1993 and 1994. Those who perpetuate that type of violence and who threaten similar violence should not have the benefit of this Nation's bankruptcy laws.

I speak to this issue from extensive personal experience as a lawyer involved in litigating this precise issue for more than a year. Although I certainly do not seek out this honor, I suspect I might be the legal expert on the current willful and malicious injury exception to discharge under the current Bankruptcy Code, and why the existence of that exception simply is not a sufficient answer to the problem that the Leahy-Schumer amendment seeks to remedy.

I have litigated this issue in six different bankruptcy courts resulting from the judgment that my clients obtained in Portland, Oregon, in February 1999. I filed that case on behalf of those clients in October 1995. After 3 1/2 years of delays and other tactics, the jury, in February 1999, awarded over $100 million in damages under the FACE statute which Congress passed and the President enacted in 1994.

My clients were two reproductive health care clinics and four individual physicians. They have faced constant attack by anti-choice extremists who have threatened their lives and who believe that they are not required to follow the laws of this country. As a result, my clients had to spend hundreds of thousands of dollars for security devices to protect themselves from violent attack. That included bullet-proof vests, bullet-proof windows, wigs, disguises, and motion detection devices at their homes.

The jury's damage award included full compensation for those out-of-pocket losses, as well as significant punitive damages to deter future violations. However, my clients have not collected a single cent of that award, and the tactics continued after trial by an abuse of the bankruptcy system.

There were 12 individual defendants in the case, and 6 of them filed for bankruptcy after the verdict in 6 different places across the country. I have litigated in Baltimore, Maryland; Greenbelt, Maryland; Norfolk, Virginia; Jackson, Mississippi; Chattanooga, Tennessee. The last one is escaping me at the moment, but I have litigated in six different bankruptcy courts the exact same issue that I tried in a jury trial that lasted a month and that I tried after 3½ years of pre-trial proceedings in that court.

The proposed amendment, in my view, would do a lot to prevent further abuse of the Bankruptcy Code. Unfortunately, the current Code, however, allowed the defendants the opportunity to abuse the system. The actions of these defendants are totally inconsistent with the objectives of the Bankruptcy Code to give honest debtors a fresh start.

There was no question in my case that every one of the defendants who filed for bankruptcy did so precisely to avoid my clients' collection efforts. Five of them filed on the eve of their depositions. One of them filed on the day of his deposition, and he is Michael Bray, who has also served time in Federal prison for bombing abortion clinics, seven of them.

These defendants have vowed never to pay any award obtained by an abortion provider. They claim not to be subject to the laws of this Nation. Unlike the honest debtor whom the Bankruptcy Code is intended to protect, these defendants never sought to work out a payment plan to pay any part of the judgment. They simply sought a discharge in bankruptcy so that the jury's verdict would be a complete nullity and they would be able to thumb their noses at the system. This is an abuse of the bankruptcy laws.

I litigated it in six different bankruptcy courts. Fortunately, I have been successful. We have won in four of those bankruptcy courts on the dischargeability question, on the willful and malicious injury concept. We have won that, however, over a year of litigation, where I had to relitigate and relitigate over and over again the exact same issues that were tried in the Oregon case. This is standing the doctrines of res judicata and collateral estoppel on their heads.

My firm did all of this for free. We volunteered our time, over 3,000 lawyer hours, just in these bankruptcy cases over the course of a year, not to mention the out-of-pocket expenses. However, it is unfortunate that few private lawyers would be willing to undertake this task, and my clients, who are individual physicians, cannot do this themselves. It simply costs too much.

I expect that critics of the amendment will ask why it is needed, given that I have won in four of the bankruptcy cases. To this, I have two brief responses. First, an amendment that will make clear what the law already provides should not be controversial.

Secondly, the amendment is needed so that people will not be able to abuse the Bankruptcy Code again by invoking the automatic stay, by causing the relitigation and relitigation over and over again. This is sanctionable conduct and it should not be permitted to happen again.

The FACE statute was passed overwhelmingly by Congress in 1994 to protect women and their physicians from violence and intimidation. The statute has been effective in reducing clinic violence. My clients have further protection because of that statute, and the judgment and the injunction that they obtained under the FACE statute has gone a long way to ensure their personal safety.

The Senate passed the Schumer-Leahy amendment just last year with 80 votes in favor of its passage. My personal experience both before and since that vote only confirms that the Senate was absolutely correct then in voting in favor of this amendment and it should do so again now. Those who commit acts of violence should not be permitted to perpetuate their illegal conduct by abusing the bankruptcy system.

Abortion clinic bombers should not be able to even argue the willful and malicious injury issue. Like those convicted of driving while intoxicated or failure to pay child support, sound public policy compels that those who commit violence against abortion clinics must be held accountable without recourse to bankruptcy. The amendment will also reinforce the utmost importance of protecting women's reproductive health.

I ask that my full written statement be made a part of the record, and I thank you, Mr. Chairman.

Chairman HATCH. Without objection, we will put it in the record.

[The prepared statement of Ms. Vullo follows:]

STATEMENT OF MARIA T. VULLO, PAUL, WEISS, RIFKIND, WHARTON AND GARRISON, NEW YORK, NEW YORK

I appear before this Committee today because of my involvement in opposing the efforts by extremists to abuse the bankruptcy process and avoid paying judgments obtained under the Freedom of Access to Clinic Entrances Act (FACE). I was lead counsel for the plaintiffs in *Planned Parenthood of the Columbia/Willamettee, Inc., et al.* v. *American Coalition of Life Activists, et al.*, No. 95–1671–JO (D. Or.), a case in which a Portland, Oregon jury, on February 2, 1999, awarded $109 million against the defendants for their illegal treats against the plaintiffs' lives. The jury's verdict was rendered under FACE and the Racketeer Influenced and Corrupt Organizations Act (RICO), and included compensatory damages for plaintiffs' out-of-pocket security expenses plus punitive damages and treble RICO damages.

After the verdict, the federal district judge, the Hon. Robert E. Jones, issued an injunction to prevent further threats threats against the plaintiffs and the judge included findings of fact to support that injunction. Among other findings, the trial judge found as follows:

> I conclude from my independent review of the evidence produced at trial that plaintiffs have proven by clear and convincing evidence that each defendant, acting independently and as a co-conspirator, prepared, published and disseminated the "Deadly Dozen" Poster, the Poster of Dr. Robert Crist and the "nuremberg

Files" with specific intent and malice in a blatant and illegal communication of true threats to kill, assault or do bodily harm to each of the plaintiffs with the specific intent to interfere with or intimidate the plaintiffs from engaging in legal medical practices and procedures.

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At a one-month trail, the jury and the judge found that three separate items constituted illegal threats under the Face statute and extortion under RICO. Briefly, defendants threats consisted of "wanted" style posters that followed a pattern of similar posters targeting three physicians—Drs. David Gunn, George Patterson and John Bayard Britton—who were murdered following the distribution of the "wanted" posters naming them. These "wanted" poster threats are addressed in the legislative history of the FACE statute.

The RICO enterprise, and the organization through which the defendants issued their illegal threats, was called the American Coalition of Life Activists (ACLA), an organization that required its leaders to be "judgment proof." Following the enactment of FACE, in January 1995, ACLA released the first threat involved in the Oregon case, which was called the "Deadly Dozen List." The Deadly Dozen List issued by ACLA contained the names and home addresses of thirteen physicians from around the nation—three of whom were plaintiffs in the Oregon suit. Immediately after the issuance of this threat, the FBI and the United States Marshal's Service contacted the physicians on the List, informing them that they should consider this a serious threat to their lives, advising them to take security measures, and offering them 24-hour federal marshal protection.

At an event later that year in August 1995 held in St. Louis, Missouri, the defendants issued their second direct threat, again under the ACLA name. This "wanted" style poster targeted another of our physician clients and included his photograph and other personal identifying information. Again, the doctor named on this "wanted" poster was contacted by law enforcement and undertook significant precautions to ensure his and his family's personal safety.

The third threat involved in the Oregon case was called the "Nuremberg Files." After unveiling these Files in hardcopy form at an ACLA conference held in January 1996, ACLA arranged for this material to be posted on the Internet. Amidst images of dripping blood, the "Nuremberg Files" website contained the names and addresses of doctors and other health care workers around the country who provide reproductive health services, some including their children's names. Doctors who are still working appear in plain text; those who have been wounded are "greyed out"; and those who have been murdered—have a line crossing out their names. After learning of this website, the FBI again contacted the named physicians and advised them accordingly.

As the jury learned during the course of trial, my clients no longer enjoy the basic freedoms that most of us take for granted. Although they are medical professionals who live and work in relatively safe communities around the country, they have been forced to live as if under constant threat of imminent attack: they have purchased and regularly wear bullet-proof vests; they have installed extensive security systems including bullet-proof glass and reinforced steel in their homes and offices; they have warned their children's teaches of the threats by defendants; they have developed emergency plans should they come under attack, Including instructing a young child to hide in the bathtub should he hear gundshots; they vary their routes to and from work to protect themselves from assailants; they have installed window coverings to thwart snipers; they have purchased and wear disguises to avoid being recognized; and they are ever-vigilant in public. They are not secure in their homes or in their offices. They do not sit by windows in restaurants. And they even refrain from hugging their children in front of open windows.

The passage of FACE has had a significant impact on the lives and safety of reproductive health care workers. But FACE and other statutes that are intended to combat violence of all forms will not be fully enforceable if those who are found liable for clear violations of the law are able to evade their obligations by filing for bankruptcy and avoiding the consequences of their illegal actions. The proposed amendment to the Bankruptcy Code is one important way to ensure that FACE is not rendered a nullity because of defendants' continued efforts to violate the law.

I have been extensively involved in litigating the very issue before this Committee in six different bankruptcy courts across the country. Following the jury's verdict in February 1999, my firm faced the important task of enforcing the judgment that our clients had obtained after years of litigation and a month-long trial. Following the jury's verdict, several of the defendants announced that they did not intend to pay any of the amount awarded by the jury. For example, defendant Timothy

Dreste—from St. Louis, Missour—announced to the press that he would not pay any part of the judgment against him. He stated: "I have no means of paying it, and even if I did, I would never pay it." Later that year, Dreste pleaded the Fifth Amendment to every question regarding his assets during this judgment enforcement deposition.

These statements are consistent with defendant's own Constitution, which specifically required the organization's leaders to be judgment proof. At page 4 of the document, under the heading "Doctrine and Character," the ACLA Constitution states that members of the organization "must. . .have their assets protected form [sic] possible civil lawsuits (judgment-proof)." Thus, the members of ACLA, including the defendants in our lawsuit, intentionally have made themselves judgment proof precisely to avoid having to pay any part of the judgment that my clients obtained. These are not honest but disfortunate debtors who find themselves in dire financial straits through acts beyond their control. They are not the individuals that the Bankruptcy Code was enacted to protect.

Defendant Michael Bray—who served time in federal prison for multiple clinic arson attacks—was one of the six defendants to seek bankruptcy protection following the jury's verdict in the Oregon case. Bray responded to the Judge's injunction by saying, "I have no plans to submit to those kinds of unconstitutional edicts." Bray also stated that "there's no money to be had" and that he has no intention of changing his behavior although, he said, "I may have to get creative about it, though." In a newsletter written by Bray after he filed for bankruptcy in December 1999, Bray discussed the deposition for which he never appeared and noted with respect to the Court's discovery orders requiring the production of documents, "I am good with matches." Bray sought relief in bankruptcy court—and I submit he, too, has abused the Bankruptcy Code well beyond Congressional intent.

Despite the jury's verdict, and the District Court's explicit findings of specific intent and malice, the defendants expected to obtain a "discharge" in bankruptcy—and thus not pay a single cent to the plaintiffs in satisfaction of the judgment. After months of trying of trying to obtain discovery of their assets, and after both the District Court and the Ninth Circuit denied defendants' motions for a stay of the judgment and injunction pending appeal, *six defendants filed for chapter 7 bankruptcy in six different bankruptcy courts*. These filings, themselves, were a mockery to the bankruptcy laws and the FACE statute. Fortunately, their efforts have been in vain, as we have won the dischargeability question thus far in four of the bankruptcy cases. But the process of litigating and relitigating the same issues in each of the bankruptcy courts demonstrates precisely why the proposed amendment is necessary.

In the two years since the jury's verdict, my firm has committed enormous resources to enforcing the judgment, including by representing the plaintiffs in the six different bankruptcy courts. With the District Court entering discovery orders requiring full disclosure of their assets on risk of sanctions, six defendants filed for bankruptcy in different venues, precisely to trigger the automatic stay of the Bankruptcy Code and thus put a hold on our collection efforts. Five of these six defendants filed for bankruptcy on the very eve of his scheduled deposition, with one (Michael Bray) filing on the day of the deposition itself. In connection with these bankruptcy proceedings, the defendants' lawyers have taken the position that the jury's verdict is fully dischargeable in bankruptcy, despite the "willful and malicious injury" exception to discharge that currently exists in the bankruptcy Code. These filings, and the litigation we have endured, demonstrate the utmost importance of the proposed amendment to the U.S. Bankruptcy Code.

Donald Treshman was the first defendant to file for bankruptcy, and he did so on November 2, 1999, just two days before his ordered deposition. Treshman had previously filed for bankruptcy in Texas in 1995, after another Planned Parenthood clinic obtained a judgment against him following a full trial and after Treshman transferred his house to an acquaintance. Treshman's earlier bankruptcy petition was dismissed when he abruptly moved to Maryland. This time, Treshman filed for bankruptcy on the heels of a series of rulings by the District Court in Oregon requiring full disclosure of his assets and compliance with the Court's injunction.

Three additional defendants filed for bankruptcy in the same week in December 1999 on the heels of court orders requiring full financial disclosure. Charles Wysong filed in the Eastern District of Tennessee (Chattanooga) on December 6, 1999; David Crane filed in the Eastern District of Virginia (Norfolk) on December 8, 1999; and Michael Bray filed in the District of Maryland (Greenbelt) on December 9, 1999. Each of these defendants was scheduled for a deposition *that same week*, but filed for bankruptcy to avoid that deposition and frustrate our legitimate collection efforts. Similarly, on January 18, 2000, right before his and his wife's depositions were to take place in Jackson, Mississippi, triggering the automatic stay. The last defendant to file for bankruptcy protection was Joseph Foreman, who filed in Roanoke, Virginia in February 2000 after we garnished his bank account but before we could collect on that garnishment in Virginia.

Because the proposed amendment does not currently exist, the defendants were able to invoke the protection of the automatic stay of the Bankruptcy Code, and force litigation and relitigation of the "willful and malicious injury" issue in the various bankruptcy courts across the country. This has been a lengthy and expensive process, involving a separate trustee and a separate judge in each case—each of whom has had to familiarize himself with this case. Because these defendants live in different parts of the country, my law firm has had to proceed against them in six different bankruptcy courts. In each case, we have had to commence an adversary proceeding in bankruptcy, file motions for summary judgment setting forth the prior proceedings and legal principles, and appear in those courts for multiple hearings. To date, my firm has expended over 3,200 attorney hours in litigating these bankruptcy proceedings, in addition to the time spent by local counsel in each jurisdiction and the substantial expense of filing fees, service fees, and travel around the country.

Thus far—after extensive litigation and considerable expense—we have won the "willful and malicious injury" issue in four of the bankruptcy courts. Despite these victories, enactment of the proposed amendment to the Bankruptcy courts. Despite these victories, enactment of the proposed amendment to the Bankruptcy Code is necessary because defendants should not have been given the opportunity to litigate the issue of their discharge in bankruptcy when they have clearly violated the FACE statute as intended by Congress. There is no doubt that these defendants did not seek relief from the bankruptcy courts as part of the good faith effort to work with plaintiffs on a payment plan for the judgment. Rather, defendants made it clear that they intended to seek a full "discharge" in bankruptcy and thus not pay one cent to their creditors. Without enactment of the proposed amendment, this type of abuse will continue.

As this Committee knows, Section 523(a)(6) of the U.S. Bankruptcy Code currently provides for an exception to discharge for debts resulting from "willful and malicious injury." As we have demonstrated to four of the bankruptcy courts thus far, the jury's findings of intention to intimidate and its punitive damages award, coupled with the trial judge's findings by clear and convincing evidence that the defendants acted with malice and with specific intent to threaten, satisfy the "willful and malicious injury" standard of the current Bankruptcy Code. We have argued successfully that those findings are entitled to collateral estopped effect, and that the defendants cannot relitigate those findings in Bankruptcy Court. although we have been victorious, defendants' filings constitute an abuse of the bankruptcy system that needs to be corrected—and which can be corrected in the future by an amendment tot he Bankruptcy Code. The fact that my case—with express findings going directly to the willful and malicious standard—still has required protracted litigation to determine again and again that these debts were nondischargeable underscores the important of the amendment. Not every FACE case will yield such explicit findings. Indeed, the specter of endless bankruptcy litigation in even the most straightforward cases will deter aggrieved physicians and other victims of abortion clinic violence from bringing FACE case will yield such explicit findings. Indeed, the specter of endless bankruptcy litigation in even the most straightforward cases will deter aggrieved physicians and other victims of abortion clinic violence from bringing FACE cases in the first instance.

Thus, it is my considered position, based upon my personal experience litigating the current law of "willful and malicious injury," that the Bankruptcy Code should be amended so that the bankruptcy process is not abused again as it has been abused by the six defendants in my case who filed for bankruptcy. Whatever one's position on abortion, we all can agree that anit-abortion extremists should not get away with their violence and threats of violence in violation of the FACE statute. My clients are entitled to compensation for their injuries—which include the purchase of bulletproof vests and other security devices. Defendants have continued to resist every effort to obtain satisfaction of any part of the money judgment—and they have abused the bankruptcy process as part of this improper effort.

I am confident that no defendant in my case will ultimately obtain a discharge in bankruptcy for my clients' judgment. Nevertheless, we should not be in the position of relitigating the matter over and over again because the current Bankruptcy code contains a loophole that permits this type of abuse. While defendants relitagate the "willful and malicious injury" exception to discharge in six different bankruptcy courts, judicial resources are expended to address these issues six times and who knows how many appeals will follow. The evidence at trial was undisputed that, upon the release of defendants' threats, with the advice of law enforcement, my clients purchased bulletproof vests, installed extensive security systems at their homes and offices, and took other security precautions because of defendants' actions. The jury awarded my clients their security costs as compensatory damages, and also awarded punitive damages under FACE against each of the defendants to prevent and deter further illegal activities. Allowing these defendants to abuse the bankruptcy process to dalay enforcement of the judgment totally undermines the effective enforcement of the FACE statute and the true purposes of the Bankruptcy Code.

The many months of litigation that I have endured in these bankruptcy courts confirms the need for an amendment to the Bankruptcy Code that precludes further litigation over the meaning of the words used in the current statute. The amount of time and expense necessary to relitigate these issues has been extraordinary, and the risk of inconsistent results has been real, despite my victories. The only way to prevent this from happening again is for an amendment to the Bankruptcy Code to be enacted that unambiguously provides that FACE violations are nondischargeable in bankruptcy. Without such a clear statement, future defendants in FACE actions will continue to file for bankruptcy in order to delay any efforts to hold them responsible for the illegal actions. The proposed amendment to the Bankruptcy Code is therefore necessary so that Congressional intent in enacting the FACE statute is fully effectuated and the bankruptcy process is not abused.

Thank you for you consideration.

Chairman HATCH. Mr. Zywicki, we will take your testimony.

STATEMENT OF TODD J. ZYWICKI, ASSISTANT PROFESSOR OF LAW, GEORGE MASON UNIVERSITY SCHOOL OF LAW, ARLINGTON, VIRGINIA

Mr. Zywicki. Thank you, Mr. Chairman and distinguished Senators. I want to thank you for moving this legislation so quickly this term and placing it with such a high priority because I think it really is an important piece of legislation and I am pleased that it is moving forward.

I have attached to my statement a time series that really sort of blows the mind when you look at it. The upward spiral in bankruptcy filing rates just since 1980 is really quite striking. We have seen a brief respite in recent years, but I haven't talked to anybody who thinks that that really means anything but a brief respite, and nobody seriously expects that the upward trend is going to end unless we do something to address the upward trend. In fact, all the data indicates that the upward trend has started again already.

Moreover, few believe that even a small part of the fraud and abuse that is in in the system is caught. There are some very poor mechanisms in place currently to try to ferret out fraud and abuse. But under the current system with 1.4 million people a year filing bankruptcy, it is simply impossible for judges to try to locate the fraud and abuse that is going on in the system without some sort of procedural mechanisms of the type that are provided for in this bill.

As a result, the efforts that have been attempted to try to hit fraud and abuse are haphazard. They are applied unequally, unfairly. They really mock the rule of law and there is really no sense in which the Bankruptcy Code is being applied consistently, fairly, or equally throughout the country.

Moreover, the fact that there really is abuse going on has created a widespread perception in the public that the bankruptcy system is really just a place where you go to scheme your creditors. The public really thinks of the bankruptcy system as a big game these days, and I think in the long run that is really detrimental in that it will undermine faith in the bankruptcy system generally. So I think it is important to get a hold of the fraud and abuse, both to ferret out fraud and abuse, but also to reinstill faith in the public that the bankruptcy system is working the way it is supposed to.

This bill does that. This bill is an incremental, common-sense, experienced-based attempt to come to grips with the fraud and abuse that is in the system, and to rebalance the bankruptcy system to try to get a rein on some of the things that have really manifested themselves increasingly in recent years.

It preserves the fresh start. It doesn't deny anybody the right to file bankruptcy, but it targets the abuses that we see in the system, whether it is high-income people shirking debts they can repay, whether it is the scheme of fractional interests that are used to prevent banks from exercising their legitimate foreclose rights, whether it is hiding assets, all the different sorts of things that are going on.

I think the bill shows a striking amount of common sense and grounding and experience of what is going on everyday in the bankruptcy courts, while at the same time preserving the integrity of the bankruptcy system for those who need it.

I think it is important to recognize that being pro-debtor in bankruptcy is not the same thing as being pro-consumer. Most consumers pay their bills, so that taking it easy on debtors who don't pay their bills, for instance, doesn't help consumers who do pay their bills. Being pro-debtor is not the same thing as being pro-consumer.

Bankruptcy losses for a business are a business expense. They are the same thing as paying the electric bill, paying salaries, paying rent, paying taxes. To the extent that they have bills that they can't collect, that is a cost of business, and just like rental payments, electricity payments, all these other expenses, get passed on to consumers.

It is inevitable that some bankruptcy losses get passed on to consumers, and they get passed on in a variety of ways. It is not just interest rates. It is also higher down payments, say, on a car because creditors are unwilling to extend as much credit and risk.

There was a story on bankruptcy in Fortune magazine, bankruptcy in Memphis, Tennessee, which is the bankruptcy capital of America. The story reports that in Memphis, where the bankruptcy filing rate is 4.5 percent of the families every year file bankruptcy in Memphis, the down payment on a used car in Memphis is the wholesale price of the car. Why? Because nobody is willing to extend any credit that they could be left hanging out on, so the down payment allows them to recover what they have to pay.

Creditors suffer, and in particular small creditors suffer. What has been striking about this bill is from the very beginning, it is small businesses, it is credit unions like we heard from today, it is small department stores like Boscov's who are trying to run credit operations. It is small furniture companies who are trying to sell furniture on credit.

Throughout the entire process, these small creditors are the ones who have supported it. Why? Because they have the most difficulty passing these losses on to other consumers because they simply don't have the revenue base to spread it in the way that other people might.

Finally, I think this sends an important moral message that people should pay their debts if they can pay their debts. And it doesn't expect the impossible; it doesn't expect people to pay what they can't pay. It says if you can pay 50 percent or 60 percent or 70 percent of your debts, if you can do that and you can pay a substantial portion of your debts and you make above the median income, you should do that as a condition for discharge. You will not be denied the right to file bankruptcy. It simply places a condition on your ability to file bankruptcy to keep your promises to the extent that you can.

I have identified about 7 to 10 percent of filers who would be affected by the means test. There is one study that purports to find otherwise, but it is methodologically flawed. I could talk about that more. It claims to only find 3 percent, but it is a fundamentally flawed study. We are talking about recovering $3 billion, roughly, that would otherwise be discharged.

I see that I am out of time. I would be happy to address some of the other things that have come out in the testimony, but I want to add one last message, which is this has been going on for a few years. When the bankruptcy bar starts attacking the bankruptcy bill and that sort of thing, it seems like they get you in the catch–22.

When the economy is good and filings are falling off a little bit, they say, look, we don't need bankruptcy reform, filings are tapering off on their own. When there is a recession on the horizon, they say, well, bankruptcies are going to rise and now is not the time to tighten up the bankruptcy laws.

Is there ever a time? If you can't tighten them in good times and you can't tighten them in bad times, when is the time to think about reforming the bankruptcy system? I think now is the time to do it, and it is the time to do it in a balanced, common-sense, experienced-based kind of situation like we have here, which is it does not deny people the right to file bankruptcy, but targets the fraud and abuse in the system.

Thank you.

[The prepared statement of Mr. Zywicki follows:]

STATEMENT OF TODD J. ZYWICKI, GEORGE MASON UNIVERSITY SCHOOL OF LAW, ARLINGTON, VIRGINIA

Distinguished Senators, it is a privilege to appear before you today to speak on the subject of "Bankruptcy Reform." At the end of the last congressional session this body passed by an overwhelming majority a bankruptcy reform bill that would bring balance and sanity to a bankruptcy system that is threatening to spiral out of control. It has been reintroduced this session as S. 220 (the "Bill"). Recent reports indicate that bankruptcy filing rates have begun to rise again after a brief respite in recent years. Clearly the time is right to address some of the problems with the bankruptcy system. Recognizing this, I am pleased to see that this Committee has acted promptly to introduce a bankruptcy reform Bill and to hold hearings on the issue. I am pleased to provide my views on the matter. I hold both a J.D. and a Master's Degree in Economics. I was also a John M. Olin Fellow in Law & Economics at the University of Virginia and am a tenured member of the faculty at George Mason University School of Law, one of the premier centers for the study of economic analysis of law. In addition to my publications in law reviews, I have also published several articles in peer-reviewed economics journals. As such, I believe that I am in a sound position to discuss both [Lc legal and economic aspects of the current bankruptcy system as well as the probably effects of the bankruptcy reform Bill.

This Bill represents a thoughtful and well-considered effort to address many of the problems that are manifest in the bankruptcy system today. The Bill makes incremental reforms to the consumer bankruptcy system to address many of the loopholes and technicalities that opportunistic debtors have found to evade their financial and personal responsibilities. The reforms provided for by this Bill are grounded in commonsense and experience derived from the observation of the day-to-day operation of the bankruptcy system in practice.

The current system has been little-changed since its enactment in 1978. Since that time the number of personal bankruptcies is roughly five times larger than when the Code was enacted. Today, some 1.4 million Americans troop through the bankruptcy courtrooms every year. This growth in numbers has been matched by a growing sophistication among lawyers and the public about the opportunities for fraud and abuse-both legal and illegal-in the bankruptcy system. Few reasonable observers believe that even a small fraction of the fraud and abuse present in the system is caught. As a result, similarly-situated debtors and creditors throughout the country suffer from dissimilar and unpredictable treatment on the basis of accident of geography or judicial whim. By guaranteeing unequal treatment for similarly-situated individuals, the system mocks the rule of law. In turn, this undermines public confidence that the bankruptcy system is operating fairly and efficiently. Instead, it is increasingly viewed as a system prone to cynicism and manipulation, and a free-ride for debtors lacking in conscience and personal responsibility.

Thus, the current system suffers from a crisis of both real and perceived abuse. This Bill addresses both of these problems. This Bill rebalances the bankruptcy system, by taking sensible steps to address many of the most prominent abuses by both debtors and creditors that have been manifested in recent years. At the same time, it preserves the commitment to the fre;'i start for all debtors who need it. By preserving the fresh start but also addressing abusive behavior, this Bill will restore fairness and efficiency to the bankruptcy system and thereby restore public confidence in the system. A failure to act in a sensible and rational way today will lead to continuing abuse and continuing public frustration. Acting sensibly today will head-off more drastic and ill-considered action later.

Being pro-debtor is not the same as being pro-consumer. When some people get a free-ride in bankruptcy, the rest of us are forced to pick up the slack. The overwhelming majority of Americans pay their Bills and live up to their financial responsibilities. But it should not be forgotten that those who pay their Bills inevitably have to pay more to make up for those who do not. Bankruptcy losses are a cost of business. Like all other business expenses, when creditors are unable to collect debts because of bankruptcy, some of those losses are inevitably passed on to responsible Americans who live up to their financial obligations. Every phone bill, electric bill, mortgage, furniture purchase, medical bill, and car loan contains an implicit bankruptcy "tax" that the rest of us pay to subsidize those who do not pay their bills. We all pay for bankruptcy abuse in higher down payments, higher interest rates, and higher costs for goods and services. I can see no good reason why a schoolteacher earning $30,000 a year should have to pay more for a mortgage or more for a new couch because some other guy making $100,000 a year finds it inconvenient to pay his debts. I can see no good reason why a nurse earning $40,000 a year should have to pay more for a car loan because some doctor earning $250,000 doesn't want to pay for his Mercedes.

This bankruptcy "tax" takes many forms. It is obviously reflected in higher interest rates. But it is also reflected in higher down-payment requirements, as creditors desire greater up-front payments to reduce the risk of nonpayment. It is reflected in shorter grace-periods for paying bills and higher penalty fees and late-charges for those who miss payments. Finally, it is reflected in fewer benefits to consumers, whether the co-branding benefits offered by credit cards today or such things as greater customer service or extended business hours. Retailers raise their prices or close their credit operations. Regardless of which of these forms it takes, it is evident that the rest of us suffer when some people choose not to pay their bills.

Moreover, it is lower-income and fixed-income Americans who suffer the most, as it is they who have the fewest credit choices and the least ability to absorb increased credit and other costs. When furniture stores are forced to close their credit operations because of bankruptcy losses, this further restricts the options of low-income creditors. When credit card issuers find it infeasible to issue credit to low-income borrowers, those borrowers are not made better-off by having their choices reduced. Instead, if they need a new transmission or new suit, they are forced to turn to pawn shops and high-interest "payday" lenders who offer terms far more abusive than any credit card issuer. *See* Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAPMAN L. REv. 79 (2000). Consumers as a whole, and especially low-income consumers, are not made better-off when bankruptcy losses increase prices and decrease service.

Creditors also lose from a runaway bankruptcy system. Smaller businesses and small creditors suffer the most from a runaway bankruptcy system, as they tend to have the narrowest margins and the least ability to spree those losses among their customers. The small-town furniture store selling couches and end tables on credit suffers a lot when his customers don't pay up. As do independent car salesmen, jewelers, contractors, and other small businesses who extend credit to their customers. Thus, it is not surprising that support for bankruptcy reform comes from across the full spectrum of creditors, but small creditors, such as small retailers and credit unions, are among the strongest supporters of bankruptcy reform.

The Bill will also reinforce the lesson that bankruptcy is a moral as well as an economic decision. Filing bankruptcy reflects a decision to break a promise made to reciprocate a benefit bestowed upon you. The moral element of bankruptcy is reflected in the observation that the English word "credit" comes from the Latin word for "trust." Parents seek to teach their children values of personal and financial responsibility, and promise-keeping and reciprocity provide the foundation of a free economy and healthy civil society. Regrettably, the personal shame and social stigma that once restrained opportunistic bankruptcy filings has declined substantially in recent years. We have "defined bankruptcy deviancy downward" such that it has become a convenient financial planning tool, rather than a decision freighted with moral and social significance. Requiring those who can to repay some of their debts as a condition for bankruptcy relief sends an important signal that bankruptcy is a serious act that has moral as well as economic consequences. Moreover, reducing the number of strategic bankruptcies will reduce the bankruptcy tax paid by every American family on goods and services, giving them more money for groceries, vacations, and educational expenses.

The Bill establishes a much-needed system of means-testing to force high-income debtors who can repay a substantial portion of their debts without significant hardship to do so. Under current law, there are few checks on high-income debtors seeking to walk away from their debts and few safeguards to prevent bankruptcy fraud. Current law requires a case-by-case investigation that turns on little more than the personal predilections of the judge. The Bill narrows the judge's discretion by establishing a presumption of abuse where a high-income debtor has the ability to repay a substantial portion of his debts, as measured by an objective standard. At the same time, the judge will retain discretion to override this presumption in cases of hardship. Means-testing is not a panacea for all of the ills of the bankruptcy system. But by focusing judicial discretion on the existence of real hardship and reducing procedural hurdles to challenging abuse, the Bill's reforms will vindicate the rule of law and reduce abuse.

By targeting high-income bankrupts with substantial repayment capacity, it is estimated that means-testing will recover roughly $3 million of the $40 million discharged in bankruptcy every year. Although means-testing will affect only 7–10% of bankruptcy filers, but focusing scrutiny on those high-income debtors who can repay a substantial portion of their debts without significant hardship, the Bill makes possible the recovery of substantial losses with minimal administrative cost. Equally important, means-testing will have no efect on those making less than the minimum income threshold provided. Thus, for the 80% of filers whose income lies beneath the state median, means-testing will have no effect whatsoever.

It should also be stressed that means-testing will not prevent anyone from filing bankruptcy and receiving a bankruptcy discharge. Instead, it will simply condition the discharge for affected filers to pursuing a chapter 13 repayment plan rather than going into chapter 7. In fact, the means-testing rules will simply govern eligibility for chapter 7 relief; it has no impact on the confirmation of the debtor's chapter 13 plan. In approving the debtor's plan the court will still apply the budgetary processes provided for under current law without any consideration of the means-testing eligibility rules.

The means-testing provisions also provide an excellent example of the incremental and balanced approach to this issue. Under current law, it is already the case that the primary factor for courts to consider in deciding whether to dismiss a debtor's case for substantial abuse under § 707(b) is whether the debtor can repay a substantial portion of his debts without significant hardship. Overwhelmed by the number of cases they confront and lacking the will to enforce its provisions consistently, however, it has been observed by one scholar that many perceive § 707(b) to be a "dismal failure." Jack F. Williams, Distrust: *The Rhetoric and Reality of Means-Testing*, 7 AM. BANKR. INST. L. REv. 105 (1998). The Bill simply creates a more formal and reliable mechanism for implementing the goals that bankruptcy courts are already seeking to apply, but will do so in a way that more efficient and fair than the current system. *See* Edith H. Jones and Todd J. Zywicki, *Its Time for Means-Testing*, 1999 BRIGHAM YOUNG UNIVERSITY L. REV. 177.

The Bill also targets a whole range of other abuses of the bankruptcy system, including such things as the use of "fractional interests" to prevent legitimate foreclosures and abuse of the cramdown provisions of the Code by filing bankruptcy simply to strip down the value of a secured creditor's claim. It creates new protections from bankruptcy "mills" and ensures that bankruptcy filers undergo credit counseling to try to workout a consensual solution to their financial problems. The Bill also eliminates abuse of unlimited homestead exemptions, a reform advocated by even. the Bill's critics. In short, it reflects practical solutions grounded in common-sense experience regarding the problems in the bankruptcy system. Contrary to the selective outrage of its critics, however, the Bill does not limit itself to reducing abuse of the homestead exemption but takes a comprehensive approach to rooting out all forms of bankruptcy abuse.

It has been claimed by some that the Bill would negatively impact the ability of divorced spouses to collect spousal and child support. This claim is based on vague, speculative, and inaccurate accusations about how the nondischargeability of certain debts will impact post-petition efforts to collect these obligations. In contrast to these speculative accusations, the Bill offers concrete assistance to non-intact families in several ways. Among its numerous provisions protecting the rights of former spouses and children are the following protections: (1) Extends the scope of nondischargeability of spousal support obligations to make nondischargeable certain property settlements, (2) excepts state child support collection authorities from the reach of the automatic stay, (3) elevates the priority level of child support to first priority, (4) makes exempt property available for the enforcement of domestic and child support obligations. These speculative claims about the negative effects of the Bill appear to be simply a concerted effort by the Bill's opponents to distract attention from the real reforms and protections included in the Bill.

Moreover, the Bill's provisions on credit card nondischargeability merely rationalizes some exceptions to discharge and closes loopholes in the current law relating to the misuse of credit cards. Given this modest aim of simply closing loopholes in the already-existing exception to discharge for credit card fraud, it is difficult to see how 'his reform could have more than a trivial effect on collection of spousal support payments. Nor have the Bill's opponents supplied any details about the size of this purported effect. Assuming the effect is non-trivial, it is also not unique to make certain debts nondischargeable on the basis of public policy. Current law already makes a multitude of exceptions to discharge, including such things as tax obligations, fraudulently incurred debts, student loans, and victims of drunk drivers. As a result, the Bill would no more "pit" postpetition child support obligations against credit card issuers than current law "pits" child support obligations against the victims of drunk drivers, the victims of fraud, student loan obligations, or tax obligations. Indeed, the burden on a debtor from nondischargeable credit card debts will be substantially smaller than the financial burden on a debtor from the inability to discharge fraud liabilities, tax liabilities, student loan debts, and drunk-driving judgments. That opponents of the Bill have instead singled-out credit card issuers for criticism says more about their desire to demonize the credit card industry and less about their commitment to protecting women and children or to real bankruptcy reform.

In contrast to the broad-based support for the Bill, opposition primarily has come from one isolated comer—lawyers. Certainly the opposition of some lawyers is based on sincere, albeit mistaken, beliefs about the content and impact of the legislation. But it is ironic that bankruptcy lawyers have been quick to question the motives of creditors in seeking reform, while remaining slow to acknowledge their own stake in opposing reform. James Shepard, a member of the National Bankruptcy Review Commission, estimates that bankruptcy is now a $5 billion a year industry for lawyers and others. By reducing filings among high-income filers and reducing the cost of bankruptcy cases by making them more predictable and less expensive, means-testing will reduce both the volume and expense of bankruptcy cases. By closing loopholes, the Bill reduces the need for lawyers to find those loopholes. The Bill also will reduce bankruptcy filings by requiring bankruptcy lawyers to inform their clients of availability of non-bankruptcy alternatives, such as credit counseling, and by cracking down on bankruptcy "mills" that mass-produce bankruptcy petitions with little regard to the welfare of their clients. Put simply, more bankruptcies means more money for bankruptcy lawyers, and fewer bankruptcies means less money for bankruptcy lawyers. Also to the dismay of bankruptcy lawyers, the Bill elevates child support obligations to the first administrative priority—a position currently occupied by attorneys' fees obligations. Efforts in the bankruptcy bar to downplay the importance of this protection for divorced mothers appear to be little more than a cynical effort to hide the self-interest of bankruptcy lawyers behind the skirts of divorced mothers.

Balanced bankruptcy reform preserves the protection of the bankruptcy system for those who need it, while limiting abuse by those who are preying on that generosity simply to evade their financial responsibilities. This Bill brings balance to a consumer bankruptcy system that has become a tool for rich and savvy debtors to evade their financial responsibilities. America has one of the most charitable and forgiving bankruptcy systems in the world and many of those who file bankruptcy truly need it as a consequence of personal trouble. But too many people today are preying on our charity and using the bankruptcy system not because they need it, but simply to evade their responsibilities or to maintain an unrealistic and extravagant lifestyle at the expense of those who live responsibly. Ignoring rampant abuse undermines public support for the bankruptcy system generally, which will eventually hurt those who legitimately need bankruptcy relief.

There has been much talk in the media and elsewhere about the surge in consumer bankruptcies in recent decades. It should be noted that this discussion is largely beside the point in the current context. This Bill does not deny anyone the right to file bankruptcy, nor does it apportion blame for bankruptcy filings. It simply provides pragmatic solutions to identifiable problems in the current bankruptcy system. To the extent that larger bankruptcy issues are implicated, however, it is evident that this Bill is an appropriate response to the problem. Two identifiable factors present themselves as explaining the rise in consumer bankruptcy filings in recent decades. First is a change in the relative costs and benefits associated with filing bankruptcy. Second is a general decline in the personal shame and social stigma associated with bankruptcy.

It has been estimated that almost half of Americans would benefit financially from filing bankruptcy after engaging in some basic pre-bankruptcy planning. Moreover, because of the structure of property exemptions under bankruptcy and state law, wealthier individuals gain the greatest benefits from filing bankruptcy because they can protect larger amounts of property in bankruptcy. Given the financial benefits created by the enactment of the 1978 Code, it is little wonder that consumers have increasingly recognized and acted on the financial benefits of filing bankruptcy.

At the same time, the costs of learning about and filing bankruptcy have decreased dramatically. Daytime television and the Yellow Pages are awash in bankruptcy advertisements. The mass production of bankruptcy petitions by bankruptcy lawyers have driven down prices for bankruptcy services. In fact, scholars have reported that one of the most difficult tasks confronting lawyers is persuading their clients that there really is no catch to filing bankruptcy, because clients routinely object that the whole things sounds “too good to be true.”

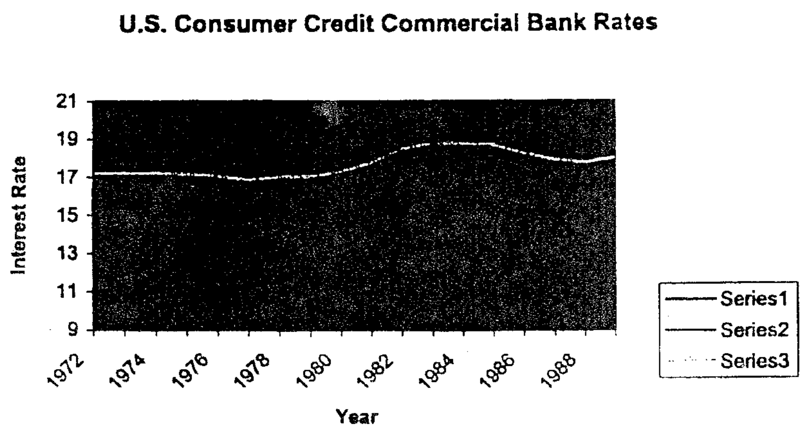
There is also little question that the social stigma associated with filing bankruptcy has declined over time. Singer Toni Braxton filed bankruptcy, despite having recorded two albums that had earned $170 million in sales at the time, and despite owning a baby grand piano, a Porsche, and Lexus. She later appeared on Oprah Winfrey, who questioned Toni on her purchase of $1,000 in Gucci silverware shortly before filing bankruptcy. Toni's response: “I only spent about $1,000 on it. If that made me broke, then I was truly in bad shape. It's Gucci-I love it. I'd buy it again. And now that I get a huge discount because I've given them so much pub, I can really shop.” This attitude, of course, is not limited to pop music stars, as evidenced by the comments of one individual to CNNfn, “When I found out-this was watching it on the news, in the newspapers—that more and more people are doing it [filing bankruptcy], and . . . it's not just a middle class you know, upper class too-rich people—everybody's doing it. And. . . I said: Why not me? You know, I'm just one more of them.”

By contrast, there is no evidence that factors such as credit cards have contributed to the bankruptcy problem. It is evident that the growth in credit cards has largely been a substitution away from other even less-attractive forms of credit, such as pawn shops, loan sharks, personal finance companies, layaway plans, and retail store credit. As shown in the attached chart, since 1995 it is housing debt, not consumer debt that has been rising most rapidly for American households. In fact, credit card debt represents only some 3% of American household debt. Moreover, defaults on credit card loans have risen in tandem with defaults on other forms of consumer credit. This rebuts the claim that credit card lenders have contributed to the bankruptcy crisis by lending to noncreditworthy borrowers. It is true that consumers have increased their use of credit cards, but this has been offset by a reduction in the use of other forms of consumer credit. If credit card issuers were acting irresponsibly, then defaults on credit cards would be rising much faster than on other forms of consumer credit. Instead, they are rising at the same rate. Empirical studies have demonstrated that increasing bankruptcies have not resulted from increased lending to higher-risk borrowers. Instead, what has happened is that all borrowers have become more likely to file bankruptcy, holding financial risk characteristics constant. What has changed is not the structure of consumer borrowing; what has changed is the willingness of individuals to file bankruptcy as the preferred means of dealing with their financial obligations.

There has also been substantial confusion about the competitiveness of the credit card market. Critics have argued that credit card interest rates have remained "high" and stable despite changes in other interest rates. This criticism is profoundly confused. First, it is meaningless to decry "high" interest rates without asking "As compared to what?" What is the "correct" interest rate on an unsecured line of credit that an individual can draw upon at his discretion? Unsecured credit lines at banks have much higher interest rates and much higher initiation fees than do credit cards. It is not clear what "high" interest rates means.

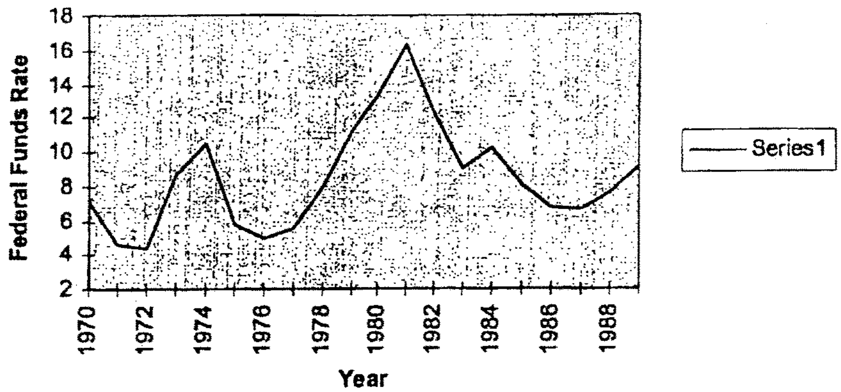
Credit card interest rates are also much less responsive to changes in cost of funds rates than other forms of credit. This is because the cost of funds comprises a relatively small percentage of the cost of credit card interest rates. The administrative costs of processing a large volume of relatively small transactions is enormous, and this is completely unresponsive to changes in the cost of funds. Consider the following two graphs, reproduced from my article The Economics of Credit Cards:

CHART 1: U.S. CONSUMER COMMERCIAL BANK RATES, 1972–1989



Series 1: New Automobile Loans (36–48 months)
Series 2: Personal Loans (24 months)
Series 3: Credit Card Plans

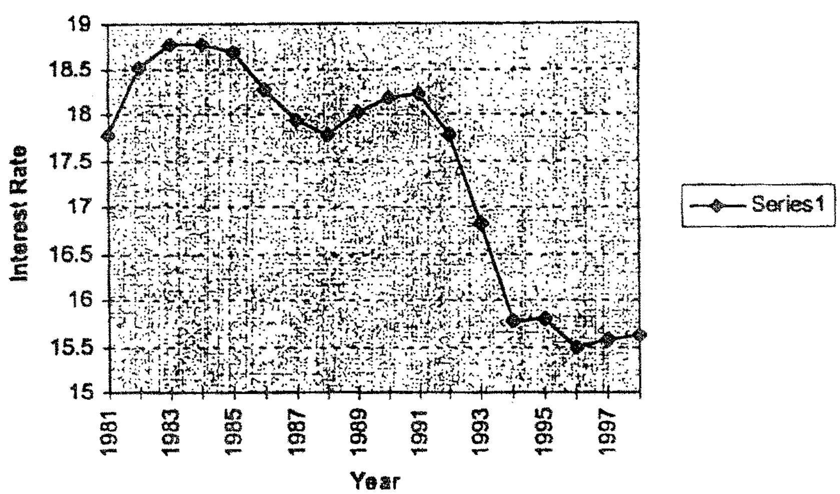
CHART 2: FEDERAL FUNDS INTEREST RATE, 1970–1989



As these two Charts demonstrate, during the 1970s and 1980s the Federal Funds rate rose and fell dramatically over time. Moreover, the rates on mortgages and car loans rose and fell accordingly. Nonetheless, credit card interest rates remained relatively constant. The reason was not because of any collusion or improper behavior by credit card issuers, but simply because the cost of funds comprises only 25% of the cost of credit card interest rates, whereas it comprises 80–90% of the cost of a mortgage or car loan.

Nonetheless, credit card interest rates have fallen dramatically in recent years:

CHART 3: CREDIT CARD INTEREST RATES, 1981–1998

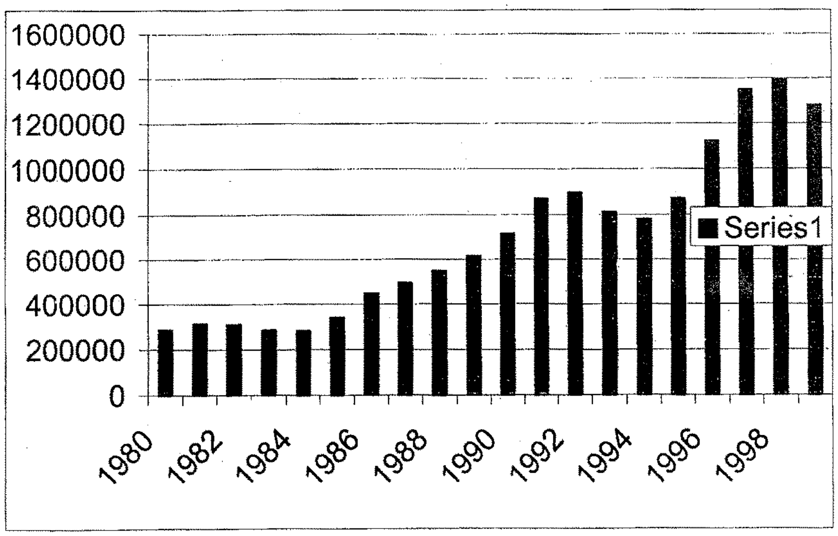


As this Chart indicates, from 1992 to 1998, credit card interest rates fell approximately 15% and have remained relatively stable since that time. Nor do we know how much credit card interest rates wou14 have fallen had bankruptcy filing rates not risen so precipitously during this same time.

Finally a fixation on credit card interest rates ignores the fact that the majority of credit card users use credit cards for transactional convenience and pay off their bills in full every month, rather than revolving balances. For those users, interest rates are irrelevant. They instead prefer a credit card that provides tangible benefits, such as frequent flyer miles or car rental insurance. They also prefer a card without an annual fee. Unsurprisingly, the market has responded by providing substantial consumer benefits and by eliminating annual fees on basic credit cards. To the extent that this is the course preferred by credit card users, this is a triumph of competition in the credit card industry, not a failure. In amending the bankruptcy code, this body should act very cautiously to make sure that it does not interfere with the operation of consumer and commercial lending markets.

Now is the time to act to reform the bankruptcy laws. This Bill is a sensible, balanced, incremental, and well-considered attempt to deal with these problems before they become intractable.

Individual Bankruptcy Filings By Year



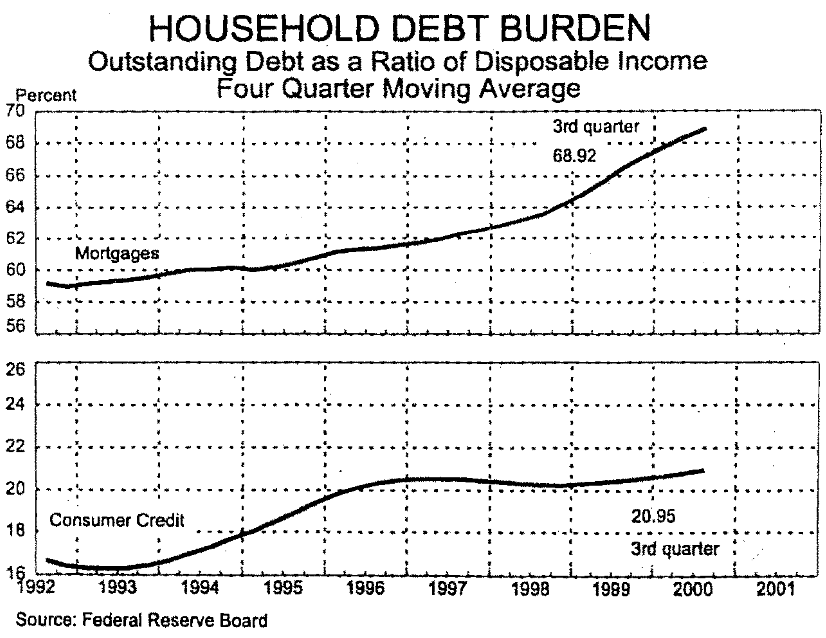
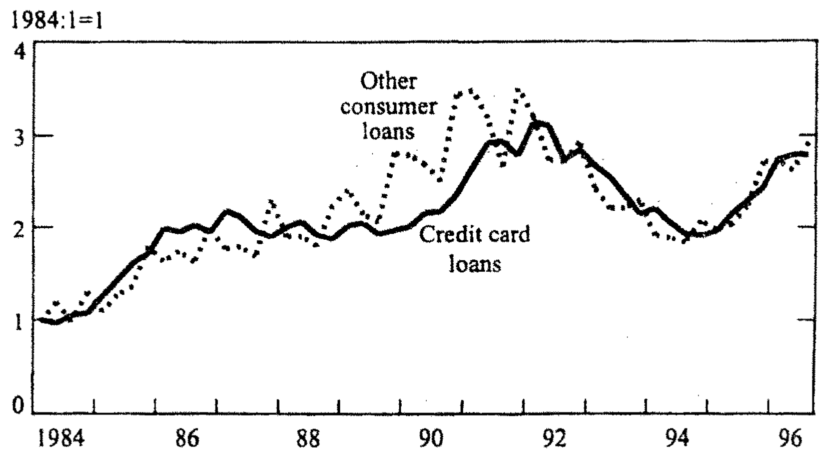


Chart 3

Relative Charge-off Rates for Credit Card and Other Consumer Loans



Source: Federal Financial Institutions Examination Council, Reports of Condition and Income.

Note: Series are scaled by their first-quarter 1984 values.

Chairman HATCH. We will each have 5 minutes.

Let me turn to you, Mr. Strauss. What does bankruptcy today do to women heading single-parent families who rely on regular support payments, and does the proposed legislation improve that situation, and if so, how?

Mr. STRAUSS. Well, the first thing that happens frequently, inevitably, is when somebody files a Chapter 13 bankruptcy, one of the most useful means of collecting support is a wage assignment or an earnings withholding order. It is called many things. That stops, and all the debtor has to do is serve that on the employer and mom, who may be depending on that next check for rent or Christmas presents or shoes or whatever, doesn't get the money.

When that is passed through our office, because we collect on cases in which women are not receiving public assistance—they are just struggling and we are enforcing their divorce order—we have to tell them it has stopped and we will go do our best to start it again.

I am in a wonderful district; the judges are very supportive of child support. But I talk to people all over the country whose judges are not the same and they say, look, you know, you want to get the support started again, seek relief from the automatic stay. It is expensive if you don't have a public agency helping you out, and it is time-consuming.

Senator BIDEN. It is an automatic stay?

Mr. STRAUSS. Pardon me?

Senator BIDEN. Now, it is an automatic stay?

Mr. STRAUSS. Well, the automatic stay goes into effect in all bankruptcies and one of the things that stops is that collection.

Another thing that happens is that is fine for people who have wages, but what about the people who are self-employed individuals? This bankruptcy bill, whereas it doesn't have the immediacy of the last provision, will tell anybody who is filing a Chapter 13 that if you want to stay in there and you want to succeed in the Chapter 13, we have set up checkpoints. One of them is you are not going to get your plan confirmed unless you have paid all of your post-petition ongoing support obligations. Another checkpoint is you are not going to get your discharge unless you have done that.

Last year, there was, I think, an amendment added by Senator Torricelli which I thought complemented both of those, and that is during this period if you are not paying it between confirmation and discharge, if you stop paying it we can dismiss your case. So these are the kinds of remedies, among many others, that women who really—and I say mostly women because there are men who are custodial parents who are in the same financial difficulties. These are the kinds of things that would help them out of it, I think, immensely.

Chairman HATCH. Overall, could you indicate your view on how well this bill protects women and children, particularly those who are dependent upon regular child support payments?

Mr. STRAUSS. Well, this bill would, first of all, create exceptions to the automatic stay for many things, but the most important one is it would put in an exception which means that the automatic stay would not stop a wage assignment, which is incidentally what Congress has mandated us to do anyway. Every single support order that is issued in any State in the United States is supposed to have a wage assignment.

Senator SESSIONS. Just so we are all on the same page, let me ask you—a wage assignment means that the employer must send the money directly to the mother or the child, right?

Mr. STRAUSS. Or to an agency like ours. We have done it and it is a system by which we collect about 56 percent of the child support. That is how important this is to make sure that is not stopped.

Chairman HATCH. Thank you.

Mr. ZYWICKI, I only have a few more minutes left, but let me just ask you this. Will means-testing mitigate the problem of bankruptcy abuse by high-income filers?

Mr. ZYWICKI. Mr. Chairman, I believe it does. In particular, what it does is it shifts the presumption in cases involving high-income filers. Under the current system, you have to actually kind of go out and find these people, bring motions to dismiss their case and that sort of thing.

What this does here is gives a nice gatekeeping approach. There is a safe harbor provision for those who make less than the median income. But above that, what it does is it just identifies those who make the above the median income, who have substantial repayment capacity without significant hardship. And it gives the presumption that they would have to repay some of their debts.

The court would still have the discretion to look at every single case to determine whether or not there is some significant hardship present in that case that means they should not repay their debts. But by creating predictability and fairness, it will mitigate the problem of high-income filers.

Chairman HATCH. Mr. Newsome, just a question for you. Do you believe that there are cases in the system which would qualify as, quote, "substantial abuse," unquote, of the Bankruptcy Code?

I understand you have been a bankruptcy judge for now, what, 15 years or thereabouts?

Judge NEWSOME. It is going to be 19 in October.

Chairman HATCH. Nineteen years. In all those years, how many cases have you dismissed for substantial abuse?

Judge NEWSOME. Of the motions that are filed, I am probably running 50 to 60 percent.

Chairman HATCH. You have dismissed about 50 percent for substantial abuse?

Judge NEWSOME. That is right.

Chairman HATCH. OK. Now, how can you blame Congress for wanting to bring more accountability to the system?

Judge NEWSOME. I don't blame Congress at all, Senator, for wanting to bring more accountability to the system. Nobody hates bankruptcy abuse more than the judges who see it all the time. All I am saying is I think that the unintended effects of your bill are going to be very, very harmful to people who don't deserve this kind of treatment.

Chairman HATCH. My time is up.

Senator Biden?

Senator BIDEN. Thank you very much. You know, there is an irony here. The bill has been stopped from passage basically based on four arguments against the bill.

By the way, I want to thank all of you, every one of you for your testimony because you have all been very helpful. But let me try to narrow this down, as I see it.

There have been four basic reasons why the bankruptcy bill has not been able to be passed. One is the argument by my friends on my side of the aisle that women receiving support and alimony will be damaged by this legislation. They will be put at a disadvantage, which you have put to rest here. I want anybody to tell me how that would be the case here.

Number 2, we are told that the second argument is that the homestead provision is not sufficiently strong. The third thing we are told is that the poor generally will be disadvantaged by this bill. And the fourth thing is that those who engage in clinic violence will be able to get out from under their obligations somehow.

Now, the irony I find here is two of those four provisions that the critics have are positions held by those who support the bill, including the creditors. I don't know a single creditor who wants somehow to be able to get out of paying a debt because they buy a $2 million home. I don't know a single creditor who has come forward who has suggested that anyone who bombs an abortion clinic, violates a stay-away order at a clinic, et cetera, should be able to discharge in bankruptcy. There is a real irony here. The creditors support the two provisions that some of us want to change.

I think we should have the stronger language of the FACE legislation in the bill. I support that. I also think that we should have a flat limit nationwide on how much you can protect your home. I think the limit should be around $100,000, maybe $250,000, I don't know, but not where it is now, although as the Senator said, we have tightened this up a lot. He and I both think we could go much further. So there is an irony here.

I am going to focus on the two things where creditors and debtors disagree, or at least those purporting to represent debtors disagree. The first one is the argument that the poor and disadvantaged or the women receiving alimony or support payments are disadvantaged.

The only legitimate criticism I have heard based on any fact is what you have put forward, Judge Newsome, and that is the real problem is the burdensomeness of getting out from under this legislation, making safe harbor work.

Does anyone on this panel think that any truly poor person is, on the face of the legislation, subject to a more onerous test than they are now? Anyone?

Judge NEWSOME. Yes.

Senator BIDEN. I don't mean burdensome. I mean just on the face of the legislation.

Judge NEWSOME. Not burdensome, but the fact that you have eliminated the ability to get rid of debts under certain provisions of 523—you have eliminated the ability to do that in Chapter 13—yes, I think that that could impact very negatively upon people of very modest means.

Senator BIDEN. Well, how about people on the—

Judge NEWSOME. Senator, if I could just interrupt you for a second, that is also the argument about child support. What you have done by way of amendment to Chapter 13 is that you have made it possible for credit card companies and others who might allegedly hold, not necessarily, but allegedly hold a non-dischargeable debt based upon 523(a)(2) to—

Senator BIDEN. Explain what 523(as)(2) is.

Judge NEWSOME. 523(a)(2) deals with fraud, and at this point at least it requires a creditor to bring a complaint against the debtor alleging that he committed fraud when he ran up his credit cards. It is not just credit cards; it is any kind of secured debt.

Senator BIDEN. So if there is fraud proven, your point is that creditor goes to the head of the line, above alimony?

Judge NEWSOME. No, sir. What it does is it does two things. By making it impossible to wipe out credit card debts, unless you pay a hundred percent in a Chapter 13 the debtor comes to the other end of the line, comes out of bankruptcy still owing those credit card debts to the extent he didn't pay them in the 13. That is going to compete with child support.

Senator BIDEN. But under the law, child support has to be paid.

Judge NEWSOME. That is right, but you can't get blood out of a turnip. If a guy gets garnished too much or if he gets too many payroll orders, his employer is going to fire him. It is very easy to do that in some States; Georgia, for example, I understand from my friends in Georgia.

Senator BIDEN. Mr. Strauss, you look like you wanted to comment.

Mr. STRAUSS. Well, I hate to disagree with a judge before whom I may have to appear sometime, but the bottom line is that if it was an even playing field and the credit card companies and the child support creditors had the same remedies, I would say, yes, the child support creditors may have a problem because of the resources of these credit card agencies, but the playing field is not level at all. For example, if you are collecting from wages—and we have discussed these wage assignments—it has to be served on the employer and it takes precedence no matter when served and it collects the debt first.

Also, the consumer credit protection law says that when you are collecting from a person's wages, only 25 percent of it can go to non-child support stuff. But if it is a child support thing, it can take as much as 50 to 65 percent, wiping out the ability of the other people to collect at all.

Senator BIDEN. That is right. Really, what you are saying, isn't it, Judge, is that it may cost them their job, it may cost them other things, but if they are wage-earner it is not going to get in front of collecting the child support?

Judge NEWSOME. No, but then the possibility is nobody gets anything.

Senator BIDEN. Whoa, whoa, whoa, not true. If the wage is garnished, the child support gets it first. You are saying if it causes them to end up being fired, then no one gets anything.

Judge NEWSOME. Or if they just give up and run away.

Senator BIDEN. Right, which happens all the time now.

Judge NEWSOME. All the time now.

Senator BIDEN. That happens all the time now.

Judge NEWSOME. And you wouldn't want to encourage that, would you?

Senator BIDEN. No, you wouldn't want to encourage that, but I find it a real stretch to figure out how this increases the very mentality that already exists in there.

By the way, Ms. Vullo, I compliment you on your work.

Ms. VULLO. Thank you.

Senator BIDEN. One question. How would the new amendment prevent the abuse of process that exists now? There is not a single court in America that has ruled that a violation of any order relating to a bankruptcy that relates to doing anything at an abortion clinic is dischargeable. Not one has ever done that, correct?

Ms. VULLO. To my knowledge, that is correct. There are just five cases.

Senator BIDEN. I understand that, but there is not one that has done that yet. Notwithstanding what my friend from New York tells me every once in a while, there is not one that has done it yet.

Now, you make a very valid point. You say the ability to abuse the existing law as to contesting what willful means allows this process to go on. It is costly, and thereby delays your clients and people who should be recompensed from being paid, and it costs them to stay in the game, right?

Ms. VULLO. Yes.

Senator BIDEN. How would the new legislation—I am not arguing with you, but it is a serious question—how would that prevent the same abuse of process?

Ms. VULLO. The new legislation focuses on the existence of an action or a judgment under a particular type of statute. So, for example, in my case I have a judgment under the FACE statute.

Senator BIDEN. Correct.

Ms. VULLO. The new legislation says that judgment is non-dischargeable. We don't get into the question of what willful means, what malicious means. It is an automatic non-dischargeable, and I would submit that a bankruptcy lawyer would have a very, very difficult time signing on to any document in bankruptcy court with that statute, whereas now, because of the case law that is out there under the willful and malicious injury exception, there are hundreds of cases going different ways with a lot of different nuances.

With that, as I have seen in my case, lawyers are arguing what those words mean. Despite the fact that there are cases out there on our side on the willful and malicious injury question, it does not mean that the risk of inconsistent results is not real. It is real.

Senator BIDEN. The way things are going, the likelihood is you are building case law. I support what you want to do, but the likelihood is, for example, the very cases you have taken in the various district courts, and now circuit courts probably in those—have you gotten there yet?

Ms. VULLO. I haven't gotten there. I am still in bankruptcy court. I have got several levels of appeal.

Senator BIDEN. They are, at a minimum, building the case law that suggests that these do not fall under that exception. In other words, I am not suggesting it shouldn't be cauterized now. I agree with you. I just want to make we don't put ourselves in a position of hyping this beyond what is real.

What is real is it is a costly process to have to appeal, to fight an appeal against a judgment that was warranted in the first instance. That is really the problem, right?

Ms. VULLO. There is more than that, Senator. With all due respect, there is much more than that because in my case I had specific findings from a trial judge that said specific intent and malice, and even then I was in court because I didn't have a statute that simply said judgment under FACE, non-dischargeable. So they litigated the issue.

In many, many other cases which will happen in the future—the FACE statute is not very old and in many cases that will happen in the future. I suspect all there will be will be a judgment without specific findings, and you are going to have judges all across the country interpreting what the elements of the statute are against willful and malicious injury, and they may interpret it differently, Senator.

Senator BIDEN. My time is up. Maybe I can come back to you later or personally talk to you about this. I am not suggesting you are wrong. I don't know. I find it hard to see how a judgment under the FACE Act, not in bankruptcy now—you litigate under the FACE Act. I find it hard to figure how a court would render a judgment on behalf of the client without specifying what, in fact, was the conduct. I don't know how you get there.

Ms. VULLO. It will happen, and I can give an example. The current law says willful and malicious injury requires intention to commit the injury, not simply intention to do the act. If I bomb an abortion clinic and as a result of that bombing someone dies, the intention was to do the act of the bombing, not to commit the killing.

And I would submit—and I think this would be absurd, but the current law logically would say that that debt to the victim, the dead person, as opposed to the bombed building, would be dischargeable in bankruptcy. I don't think we should debate over whether or not—

Senator BIDEN. That is an absurd reading and it would take absurd judges. We don't have that many absurd judges, except the ones that the other guys appoint, but I don't know.

[Laughter.]

Senator BIDEN. That is a joke, that is a joke. That was a bad joke. I would like to ask unanimous consent to strike that from the record because I will have 731 judges calling me and wondering if I am talking about them.

I thank my colleagues for their indulgence. Thank you very much.

Senator Sessions [presiding]. Thank you, Senator Biden.

I really want to get off this subject, and you have had a good day in the sun. If the Schumer amendment is made law, someone still would be able to file bankruptcy and delay paying your debt until such time as you went to that bankruptcy court and overcame their objection still, even though it would be easier to overcome the objection. Am I wrong about that?

Ms. VULLO. An abuser will again abuse the system potentially, but it makes—

Senator SESSIONS. But the ultimate remedy for a court is sanctions for contempt or things of that nature, it seems to me.

Senator SCHUMER. Frivolous—

Senator SESSIONS. Yes, frivolous or that sort of thing.

Senator SCHUMER. It could be a frivolous suit and subject them to sanctions and would be dismissed right away, which happened in none of these cases, as I understand it.

Ms. VULLO. That is correct. A lawyer would be hard-pressed to sign that bankruptcy petition if this amendment were in the Code.

Senator SESSIONS. Well, I would just say this about this subject, which has never been lost and is not a critical matter in the world of commercial bankruptcy: If there are other similar problems, such as extreme environmental violence that results in spikes being put in trees or union attacks on small businesses, it seems to me that we ought to consider the same type rule as is being urged upon us with regard to abortion clinics. That is all I am saying.

It does strike me that you represent abortion clinics and, as such, you want to protect those clinics from violence. But others may sue people who roll back odometers and they would like to have their cases proceed, too. So there are a lot of different issues here, and I think quality and fairness of treatment across the board is what I would favor as opposed to just targeting one issue.

Senator BIDEN. Mr. Chairman, can I ask a question?

Senator SCHUMER. Would the Chairman yield?

Senator SESSIONS. No. You will have your time.

Ms. VULLO. May I respond?

Senator SESSIONS. I am using my time up right now.

Senator BIDEN. I apologize.

Senator SESSIONS. You and I have talked about it, Senator Schumer, and I respect your concern over this issue. There are a lot of abuses in the bankruptcy court, unfortunately, such as debtors delaying just adjudication and trying to frustrate payment of debts, and that is what this reform effort is trying to correct. Sadly, this is just one example of what is going on daily in bankruptcy courts across America.

Senator SCHUMER. But I would say—

Senator SESSIONS. Thank you Senator, but I am claiming my time.

Ms. VULLO. Senator, may I respond to that, please?

Senator SESSIONS. No. I am just having my say.

Senator SCHUMER. Give her the courtesy of a response, Mr. Chairman.

Senator SESSIONS. She has had a chance to respond.

Senator SCHUMER. I would ask unanimous consent it not be taken from my good friend from Alabama's time and let Ms. Vullo respond.

Senator SESSIONS. On what subject?

Ms. VULLO. Can I grant that consent?

[Laughter.]

Senator SCHUMER. No, unfortunately you can't. It is up to him.

Senator SESSIONS. I will not object. If it doesn't cause me to lose my time, I would be glad to hear you.

Ms. VULLO. All I would want to say, Senator, is that there is documented abuse here in a particular area. All pieces of legislation deal with particular items when this committee determines and learns of some element of abuse.

Senator SESSIONS. I understand that is your view.

Ms. VULLO. The fact that there might be other abuse does not mean that documented abuse should go unremedied, and that is all we are asking with respect to this piece of legislation. It is documented and it is a group of people who do not believe they have to follow the laws of this country. People who don't believe they have to follow the laws of this country should not have the benefits of the Bankruptcy Code when they have demonstrated that abuse.

Senator SCHUMER. And I would say to my friend, just to have an analogous example, some animal rights people started shooting scientists who were experimenting on animals and then somehow claimed bankruptcy as a shield. I would support an amendment to do that.

Senator SESSIONS. Well, I think there are other problems that we could deal with and I certainly do not object. I think you make the best point, which is if you have got a documented case of abuse, you are more justified in asking for relief.

Judge Newsome, you mentioned that you granted discharges in bankruptcy for abuse.

Judge NEWSOME. No, no, I didn't grant discharges in bankruptcy for abuse.

Senator SESSIONS. Excuse me, dismissals of bankruptcies.

Judge NEWSOME. Right.

Senator SESSIONS. How many, in terms of actual numbers, have you granted throughout your career?

Judge NEWSOME. Senator, I don't know.

Senator SESSIONS. You said 50 to 60 percent of the motions.

Judge NEWSOME. And I can't tell you—

Senator SESSIONS. Less than ten?

Judge NEWSOME. Oh, no. It has been more than ten.

Senator SESSIONS. Less than a hundred?

Judge NEWSOME. Less than a hundred.

Senator SESSIONS. So it is not many. It would probably be less than 1 percent of the cases you have presided over.

Judge NEWSOME. Oh, much less.

Senator SESSIONS. In my view, the abuse procedure has failed.

Judge NEWSOME. I agree.

Senator SESSIONS. It is not an effective mechanism.

Judge NEWSOME. Not as written.

Senator SESSIONS. That is why we think, instead of having it filed in every court, having judges determining from their own feelings what ought to be granted and what not granted, that it would be preferable to have a fair, objective statutory scheme including bright-line rules based on size of family and median income. That would be an improved approach to the current problems.

Judge NEWSOME. May I respond?

Senator SESSIONS. Yes, sir.

Judge NEWSOME. The rule you have proposed is anything but bright line. There are as many ways of interpreting the means test as there are people looking at it. And if you think that there has been inconsistency interpreting substantial abuse, wait until the judges get a hold of this one.

Senator SESSIONS. Well, let me ask you this.

Judge NEWSOME. And let me just also say this. The problem with the test that is in the statute right now is that the only person who can file a motion is the U.S. trustee. The creditors can't even bring it to the trustee's attention.

So if you opened this up, if you opened the test and you got rid of the word "substantial" and just said if you commit an abuse of the Bankruptcy Code, a creditor can bring a motion to have the case dismissed for an abuse—contrary, I think, to popular belief, there is an objective set of standards under the substantial abuse test for when you should dismiss a case for substantial abuse. It has been developed in the case law and it basically is can the debtor afford to pay something in Chapter 13.

Senator SESSIONS. Well, it strikes me that it is not very difficult. If, for example, a family of four's median income is about $50,000, and that same family of four seeks to file for bankruptcy with an income of $40,000 they still get to go in Chapter 7 and would not, under S. 220 or current law, be put in Chapter 13. That is not a very difficult concept for a judge, in my view, to understand.

Now, let me ask you a question, Mr. Strauss. If a person is moved from chapter 7 to 13 because they have income above the median, and have been found to be capable of paying some of their debts they are required to repay those debts over a 5-year period, isn't that correct?

Mr. STRAUSS. Yes.

Senator SESSIONS. And during that 5-year period, you have got a Federal bankruptcy judge basically ensuring that they pay the child support first out of every single debt that is paid.

Mr. STRAUSS. Exactly.

Senator SESSIONS. Isn't that a great protection for a mother with children?

Mr. STRAUSS. Yes. We obviously prefer debtors in Chapter 13 for those reasons, especially if these other provisions are enacted.

Senator SESSIONS. Senator Feingold?

Senator FEINGOLD. Thank you, Mr. Chairman. I am pleased that we are having a hearing in committee this year. We didn't do that at the beginning of the 106th Congress, in 1999, and I thought that was a mistake. I certainly want to thank all the panelists.

In fact, the process we followed in the last Congress and in the Congress before that led to a bill that the President wouldn't sign and that a majority of the Democratic caucus wouldn't support. I am afraid we are heading down that exact same road again this year.

Of course, we have a new President, and most observers expect that he would sign the bill that the Chairman and Senators Grassley and Sessions have introduced if it gets to his desk. But, my colleagues, that doesn't make the bill any better or more fair or more balanced, or worthy of this committee or this Congress, than the one we passed last year.

Amending the Bankruptcy Code, as my friend Brady Williamson indicated, used to be a non-partisan exercise, where the Congress listened to experts, practitioners, law professors, judges and trustees, and made careful, considered judgments about how the law would work. Now, it seems we ignore the experts and, instead, do what the credit industry wants us to do. And we use parliamentary tactics to avoid reasoned consideration that harm the bill and I think actually discredit the Senate.

We all know how the procedures of the Senate were abused to pass the bankruptcy bill last year. This year, the bill has been sent right to the calendar for floor action. We have a new Judiciary Committee this year with four new members and a 50/50 split in party affiliation. I strongly believe this committee should have the opportunity to fully consider and amend the bill.

I just want to say for the record that our Leaders' agreement to have evenly divided committees is really pretty much meaningless if major legislation like bankruptcy reform doesn't really go through committee, and so there is agreement to have equal budget for staffs if major legislation is marked up in this committee before that agreement is implemented. This is a new Senate with an unprecedented power-sharing arrangement, and I think this committee should start operating on that basis, in fact, not someday, but now.

Mr. Chairman, I have a longer statement for the record that spells out my concerns about S. 220. I would like to note here that this committee should be cognizant of the extent to which bankruptcy reform has come to be seen across the country as a gift to special interests.

In that regard, I would like to ask unanimous consent that recent studies by Common Cause and the Center for Responsive Politics concerning the campaign contributions made by supporters of bankruptcy reform legislation be included in the record of this hearing.

Mr. Chairman, I am asking unanimous consent.

Senator SESSIONS. Without objection.

Senator FEINGOLD. In light of the appearance that these free-spending industries have created, we have a very heavy burden to make sure that we are serving the public interest with this kind of far-reaching legislation. We cannot meet that burden unless we slow down and open our minds to the kinds of criticisms expressed by witnesses at this hearing and by non-partisan experts in this field. For two straight Congresses, we have ignored the experts. We need to step back and take another look.

Mr. Chairman, I want to welcome in particular the two witnesses from Wisconsin, Brady Williamson and Mr. Beine, who hail from my State. Senator Kohl very much wanted to be here and extends his apologies. He is doing what we in Wisconsin consider the Lord's work. He is with Agriculture Secretary Venemen talking about the dairy industry.

We are glad you are here to provide a little Wisconsin common sense to this debate. I will hopefully be able to ask more questions in another round, but let me just use the time here remaining in my round to ask Mr. Williamson to comment briefly on whether the efforts of the National Bankruptcy Reform Commission that he chaired are reflected in the bill that passed the Senate last year and that is before the Senate again.

Brady, if you could start by recounting how the Commission went about its work and attempted to study and accommodate all the competing views and tried to come up with a balanced bill with regard to this law.

Mr. WILLIAMSON. Thank you, Senator. The Commission was created by the Congress in 1994. It had 9 members, 3 appointed by the President, 4 appointed by Congress, the House and the Senate, and 2 by the Supreme Court. It conducted hearings across the country, more than 25 hearings, heard from more than 300 witnesses, received more than 3,000 submissions, and attempted to come up with a balanced set of recommendations.

The Commission submitted its report to the Congress and the Supreme Court on October 20, 1997. It had 172 recommendations and a 1,300-page analysis of the bankruptcy law which remains available today on the Net and I still think is the single most comprehensive assessment as of 1997 of American bankruptcy law.

This legislation includes some of the Commission's recommendations. I would single out the Sessions-Kohl provision on homestead as an example of that. I would also single out direct appeals as an example of that. I would note that the Commission found no need for a needs test, as such. The Commission addressed the question of abuse in a variety of ways, we think with a little more precision and sophistication than the legislation does.

The Commission endorsed the notion of flexibility for judges. We have heard a discussion this morning about a family. I believe, Senator Sessions, you mentioned a family of four with $50,000 of income, and shouldn't it be easy to tell whether they get to go in Chapter 7 or Chapter 13. The answer is, yes, it should be if it were a normal family. But if the family had an autistic child, if the family had economic consequences, circumstances that didn't fit readily into IRS guidelines, then you have a different story. And then I think you need the flexibility and the discretion that the Code today affords bankruptcy judges.

Senator, if I could just take a minute to respond to the Senator from Delaware's friendly challenge on his four issues, first, Senator Biden, I would note that the people in the credit industry who support this legislation have been remarkably silent on the importance of the Sessions-Kohl amendment.

Senator BIDEN. That is not true, by the way. That is simply not true. That is simply not true.

Mr. WILLIAMSON. Well, Senator, then I would like to see the evidence of that.

Senator BIDEN. I will give you the evidence.

Mr. WILLIAMSON. Thank you.

Senator BIDEN. It is simply not true.

Mr. WILLIAMSON. Second, with respect to the question of the impact of this legislation—

Senator BIDEN. You mean homesteading, right?

Mr. WILLIAMSON. Yes, sir.

Senator BIDEN. OK.

Mr. WILLIAMSON. With respect to the Senator's comments about women and children, bankruptcy law is fundamentally about values, and this country and this Congress long ago decided that taxes, child support and student loan obligations should be non-dischargeable, and the reason was because we as a society place a value on that.

One of the disturbing things about the bill in the aggregate, Senator, is that it increases the categories of non-dischargeable debt. And by doing that, it places that new non-dischargeable debt in competition, inevitably, with the other non-dischargeable debt.

Senator BIDEN. You are good, Brady.

[Laughter.]

Senator BIDEN. I forgot how much I liked working with you over the years. You are so good.

Mr. WILLIAMSON. Senator, Chapter 7's only last a brief amount of time and during that period, of course, a bankruptcy judge can insist that child support be paid. Chapter 13's may last 3 years or 4 years, but one thing we haven't talked about, a dark secret here, is that 3 out of every 4 Chapter 13's fail. And when they fail and when the debtor is sent out of the courtroom into the world, each of that debtor's creditors with a non-dischargeable debt—it is passed through bankruptcy whether it is 7 or 13—is on the same footing.

They can go to the single mother or single father with children and say we want you to pass. And during the bankruptcy process, they can go to that same single mother and say, look, we will let you keep your credit card, you just have to reaffirm the debt.

Now, we haven't talked about reaffirmations here, and I think we are all aware of the instances in the last 3 years where major credit institutions have abused the reaffirmation system. This legislation needs to pay more attention to that issue.

The system is about balance, Senator, and it has to be balanced and it has to prevent abuse. Bankruptcy judges can provide balance if they have the discretion. I associate myself with Judge Newsome's remarks because we need to give bankruptcy judges flexibility, not put them in straightjackets, and that applies as well to the means test.

Senator SESSIONS. Senator Schumer?

STATEMENT OF HON. CHARLES E. SCHUMER, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator SCHUMER. Thank you, Mr. Chairman. I thank everyone here. I think this is an excellent hearing, no matter what side of the issue you are on, because we are really discussing the issues. This is our committee, I think, at its best and I appreciate everybody being here.

We were not allowed to make opening statements. I am going to make part of my opening statement now and then ask that the rest be put in the record, and then I will ask a few questions if I have time. Otherwise, I will wait for the second round.

First, I want to thank everybody, all the witnesses for being here, and especially Maria Vullo, who is an attorney from New York. As we know now, she litigated the Nuremberg Files cases.

Ms. Vullo, I can say to you that in the ante room there, two of my colleagues were talking and one said to the other I wouldn't want to be litigating against her—the ultimate compliment to a litigator.

Mr. Chairman, bankruptcy law and bankruptcy legislation is complicated. It is sometimes archaic, and I can safely say that when I walk into, say, O'Halloran's Pub on Clinton Road and see my constituents, they are not saying what is new with the homestead exemption, the means test and safe harbors, Charlie.

The fundamental idea behind bankruptcy law and bankruptcy reform is actually a fundamental and very simple one. Good bankruptcy reform means strengthening the protections for the neediest debtors by giving them a safety valve to deal with misfortunes that may befall them, while at the same time shoring up the system to prevent abusive filings by debtors who do not need bankruptcy protections. It is that simple, Mr. Chairman, balance the need to protect vulnerable Americans with the need to prevent abuses.

Last year, I opposed the bill that ended up emerging from the shadow conference because I think the bill got the wrong balance. I am hopeful that this year we will work to achieve truly balanced bankruptcy reform, something that is going to cure abuses but doesn't throw out the baby with the bath water.

I hope we are not going to try to jam the same bill through that came out of the shadow conference. That bill, which had been unilaterally stripped of the FACE amendment, the so-called now Schumer-Leahy amendment, had passed 80 to 17.

By now, I think everyone involved in bankruptcy knows that the FACE amendment prevents those who engage in violence and intimidation at abortion clinics from hiding behind the Bankruptcy Code to escape their court-imposed debt. This provision makes clear to those who would harm women and doctors that bankruptcy is no escape from accountability for their heinous acts. They have tried to use the bankruptcy courts for that.

Now, what could be wrong with that purpose, as my good colleague and friend from Delaware said? Probably everyone on this panel agrees with that, and the issue frankly is not pro-choice or pro-life; it is pro-law. That is why Harry Reid, who is pro-life, joined as a cosponsor immediately. That is why when I first passed the FACE law in the House we had a coalition of pro-choice and pro-life Congress members supporting it.

That is why last year Senators Jeffords, Snowe, Collins and Specter made this a wholly bipartisan effort. And that is why, when they heard bankruptcy was bring brought up again this year, Senators Reid and Jeffords quickly approached me to stress their support and desire to cosponsor the amendment.

And that is why our new Attorney General was so outspoken both publicly and privately at his confirmation hearings about his support for the FACE amendment. In the last Congress, the Justice Department was a strong supporter of FACE. In fact, I would like to ask unanimous consent that the DOJ letter I received last year showing DOJ's position which outlines why this law is so important be placed in the record.

Senator SESSIONS. Without objection.

Senator SCHUMER. Given Attorney General Ashcroft's pledge to enforce FACE and his explicit support of the FACE amendment, I hope that this year it will be included in the bankruptcy bill.

Let's not kid ourselves. Attacks on clinics and clinic workers are often planned by sophisticated individuals and organizations. Violent activists who hide their assets to avoid financial repercussions are quite capable of working bankruptcy into their schemes to commit violence without accountability if they believe it will work.

Ms. Vullo testified about the Nuremberg Files case. It is not fiction. Your testimony was riveting. What happened there was appalling and offensive. What is happening now in the bankruptcy courts is equally appalling and offensive. We need to shut it down. If we don't, there is a substantial risk that others will pervert the Bankruptcy Code and it will become a widespread tactic used by those who believe that their message is more important than our American law and the Bankruptcy Code will be perverted.

Can any of us really doubt that the groups that Ms. Vullo has litigated against, if given the chance, will not continue to force clinics and doctors, and relitigate and relitigate and relitigate? That is my dispute with my good colleague from Delaware. He is right that if these little clinics had free lawyers—they don't even have to be as good as Ms. Vullo—they would win. But they don't. The opponents have huge amounts of money and go to court after court after court. And we all know in practical effect what the consequence will be. It will be that bankruptcy will be a shield from judgment.

Now, some have argued—we hear this argument a lot—about the willful and malicious standard. They say FACE debts would be covered. First, I have never argued that FACE debts would never be covered. Certainly, some would be if they were proven to fall under the willful and malicious injury exception. But this in no way means that all FACE debts are covered by that exception.

In the Nuremberg case, the judge made explicit findings of maliciousness and intentionality that made it easier in the bankruptcy cases to argue that the willful and malicious injury exception applies. But even in these cases which should be slam dunks, Ms. Vullo and the plaintiffs have spent more than a year litigating in bankruptcy court.

What about cases where there are settlements and part of the stipulation of the settlement is we are not going to find willful and malicious and there is a judgment? Then what do we do? Many, many, many cases end in settlement, probably more than actually end in judgment. So it is vital that we make perfectly clear that FACE debts are non-dischargeable. If we don't, the individuals and organizations seeking to shut down clinics will continue to force clinics, doctors and other victims of clinic violence into a world of perpetual litigation. By doing so, they may well deter victims of clinic violence from ever bringing a case in the first instance.

Mr. Chairman, I have a lot more to say on this subject, but I am going to ask unanimous consent that my entire statement be put into the record.

Senator SESSIONS. We would be glad to. Once again, ably delivered.

Mr. Zywicki, would you respond to Judge Newsome's suggestion or statement that judges would find it difficult to interpret the means test language in this bill? How hard and complex would that be?

Mr. ZYWICKI. It is much less complex than under current law. Basically, what happens under current law is judges just kind of make it up as they go along, just sort of an open-ended inquiry. If you read the cases, you see cases all over the place. He says it is being refined by case law. That is simply not the case. The cases are all over the place, and what this does is brings order to it.

Senator SESSIONS. Cases on abuse?

Mr. ZYWICKI. Yes, cases on abuse. There is no consistency.

Senator SESSIONS. But under the proposed language of this bill, to what extent is that ambiguous or unclear?

Mr. ZYWICKI. This is much less ambiguous or unclear. It identifies things very clearly, and most importantly it provides a list of expenses and that sort of things. And then what it does is cabins at the end a judge's discretion and says, look, here is your discretion, here is a simple list to follow and here is your discretion; apply your discretion, but subject to guidance, not just according to willy nilly preferences. So I don't think there is any problem with applying the means test as it is drafted.

Senator SESSIONS. With regard to the legislation, I think it has previously been noted, but this bill passed the House in June 1998, 306 to 118, essentially this bill with the means test in it. In the Senate, it passed in 1998, 97 to 1. In the House, it passed again in May 1999, 313 to 108. In the Senate, it passed February 2, 2000, 83 to 14. In the House, it passed again on voice vote virtually unanimously, I suppose, without even a roll call vote. It passed 70 to 28 in the Senate.

There have been six different times this bill has been up and passed by overwhelming majorities. We don't want to not have hearings and let everybody talk, but sometimes it is time to stand up and vote and I think we are about at that point now.

Senator Biden, I will let you go now and if I have any follow-ups, I will follow you.

Senator BIDEN. One of the reasons I think this hearing is important is that there has been so much misinformation that has been out there across the board. I would argue initially the misinformation was on the part of the creditors 4 years ago. Now, I would argue the misinformation is on the part of those opposing this legislation.

I start off with sort of just a common-sense notion here. Why are there so many more bankruptcies? Why has that happened? Part of what our ethic was was that bankruptcy was something that was an absolute last resort and was something that you really tried to avoid because it had a social stigma related to it, beyond a financial stigma related to it. That isn't the case anymore. It is not working that way anymore. People still need bankruptcy protection. That is why we got rid of debtor prisons.

The irony here is I have been for my 28 years in the Senate characterized by the business community as too much of a pro-consumer Senator. I have found it kind of ironic that one of the things that has been argued here today is that—and I might add, Mr. Manning, without any data to support it; I have seen no hard data. I read your entire report. I have no hard data where you support the idea that you state that you have a direct connection between bankruptcy and credit card debt. I have not seen that data that you have supported here.

One of the things I heard today was the autistic child; what about the person with the autistic child? Doesn't the judge need discretion for that? Well, that is a medical expense. Under this legislation, that is set aside. Where the heck does that come in? I don't get that. Obviously, I don't want to hurt people who have autistic children, but you all make it seem like the autistic child is in trouble, you know, the parent with the autistic child.

Brady, I don't think we have been on the opposite of an issue, except this one. I can't think of it. How long have we known each other, 25 years?

Mr. WILLIAMSON. Twenty-8 years.

Senator BIDEN. As a matter of fact, I tried very hard to hire you to be my main guy. You were making too much money to come work for me.

Mr. WILLIAMSON. Senator, it was your first day in the Senate that we met.

Senator BIDEN. Well, that is 28 years, and I really have overwhelming respect for you and you know that. We have been old friends. You have supported me.

Now, reaffirmation. Are you alleging that for a creditor to insist on reaffirmation is easier under the new proposal we are making than it is under the old?

Mr. WILLIAMSON. I would not suggest, Senator, that the legislation you are holding in your right hand is a model of good draftsmanship.

Senator BIDEN. I didn't say that. Brady, stop playing games with me. Is reaffirmation, as poorly drafted as your brilliant drafting capability may discern—is it tighter or looser than the existing bankruptcy law? Remember, your legal reputation is part of this.

[Laughter.]

Senator SCHUMER. But if he demolishes it, you could always get a job with him.

Senator BIDEN. I want him any time he is willing to come.

Mr. WILLIAMSON. Senator, I would say that the intent of the folks who put that together was to make it slightly tougher.

Senator BIDEN. Not intent. Does it make it tougher, Brady, or not?

Mr. WILLIAMSON. Senator, I don't think so.

Senator BIDEN. I will get back to you on that. The second thing I want to ask you about is what new non-dischargeable category of debt do we have in this legislation?

Mr. WILLIAMSON. The category of unsecured debt that can be non-dischargeable is increased significantly.

Senator BIDEN. How?

Mr. WILLIAMSON. The time limits.

Senator BIDEN. Right, but no new category, right?

Mr. WILLIAMSON. Well, if you—

Senator BIDEN. That is what you said. You said new category of debt.

Mr. WILLIAMSON. If you expand the category of non-dischargeable unsecured debt incurred within 30 days—

Senator BIDEN. Let's go like when we were in grade school, you know, file them. Do you mean category in that if you put more of a debt within a category subjected to non-dischargeability—if you increase the number or lower the number, that is a new category. Is that what you are saying?

Mr. WILLIAMSON. It is certainly an expanded category.

Senator BIDEN. OK, then that may be more accurate, wouldn't it be, because there is no new category?

Mr. WILLIAMSON. Actually, there are.

Senator BIDEN. Name me one.

Mr. WILLIAMSON. I believe the drunk driving penalty exception is a new category of non-dischargeable debt.

Senator BIDEN. You are right. That is a good one. You agree with that, don't you?

Senator SESSIONS. Abortion clinics. How about that?

Senator BIDEN. We want to make abortion clinics non-dischargeable, too. But there is no new category of debt that the creditors are seeking, is there, that you are aware of?

Mr. WILLIAMSON. Senator, I don't want to be involved in semantics with you because of your caution about games. But if you expand from 30 days to 90 days—

Senator BIDEN. OK, but it is not a new category. It is a time limit. You argue that that makes somebody more susceptible, but it is not a new category. I mean, that is the part I am trying to get at here. I wish you would all be a little straightforward with this. You are opposed to this flat out.

Mr. WILLIAMSON. That is not correct, sir.

Senator BIDEN. Oh, give me a break.

Mr. WILLIAMSON. Senator, whether it is a category or not, it is whale of a lot of new debt.

Senator BIDEN. OK, that I buy. Just try to be straight with me. If you were staffing me and you did that to me, then I would fire you because you would not be telling me the straight stuff. Just give the straight scoop. That is all I want to know, that is all I am trying to figure out. I really mean this. That is all I am trying to figure out because a lot of games are being playing here, not by you, but everybody out here is playing games with this stuff.

What gets communicated to the press—there was a Time magazine article—I think it was Time magazine, wasn't it, that was riddled with absolute, total, complete fabrications, not because I think the guy writing the article was, in fact, somebody who tried to fabricate it, but because he heard things like new categories. He heard things like the autistic child, he heard things like be able to escape from debt on the abortion clinic. No one has escaped yet.

Ms. Vullo makes an incredible case, I think. I hope the credit card industry and I hope the creditors out there are listening because she is making a very strong point. Now is the time to put pressure on my conservative friends to accept her position.

Senator SCHUMER. Hear, hear.

Senator BIDEN. But the point is she said it straight, she said it straight. It may be someday that somebody will be discharged in bankruptcy. It may be that someone is convicted under FACE and, in fact, gets discharged, but none of that has happened yet. But what has happened is it is costly. I am just trying to get my arms around this a little bit here.

Your statement, Brady—any reasonable person listening to what you said earlier would walk away thinking that reaffirmation is easier to do under this legislation than exists today. I doubt whether any honest person would conclude that that wouldn't be the conclusion. Maybe that is not what you intended, but the way you state it, it makes it sound that way.

Creditors are not people I am crazy about because I am listed as—I am not, but I am listed as the poorest Member of Congress, literally. I mean, I am not.

Senator SCHUMER. Wait a minute.

Senator BIDEN. No, no. Seriously, the Washington Post four or 5 years ago listed me as the poorest Member of Congress because I refinanced my home to pay for Yale, Penn and Georgetown. That is what happened. And I am not because the guy who does my financial disclosure didn't list the equity in my home, because under our stupid rules in order to list the equity in your home you have to have a current assessment. It costs $500 to get one done. I didn't want to spend $500. I would rather pay it to Georgetown than do that.

To make a long story short, I am not the poorest, but I am not a debt-free guy. I am not like a lot of our colleagues here who the last thing they have ever seen is having to take that lazy susan and spin it around and decide who gets paid this month. Some of us still do that who have this job. So I don't come at this like we are going to go out there and squeeze every penny out of folks out there.

But I start off with the proposition that something is rotten in Denmark, as the old expression used to be. An awful lot of people are discharging debt who shouldn't. This voluminous increase in filings—it is exponential what has happened. Something is up, and that happened when the economy was booming, absolutely booming.

Now, I am not a real smart fellow maybe, but there is something wrong. Something is going on here, and it says to me it has got to be tightened, for a simple reason, and the gentleman on the end made the comment, as did Mr. Sheaffer. Guess what? People who come from my economic class where I grew up pay more now; they pay more. They pay more in the cost of the product at Boscov's and other places where we shop, not where a lot of the people who are getting out of the big bankruptcies shop. Nobody who has a big bankruptcy shops at Boscov's.

[Laughter.]

Senator BIDEN. I am not joking. I am not trying to be funny here. This is serious, this is serious.

So what happens? I ask my colleagues, try to think back to the time when you were just starting. You just got out of law school, you just got out of college and you are trying to buy the car and you are trying to get the first bit of credit. All that is going on here is the people it is hurting is not the wealthy people. As bankruptcies increase astronomically like this and in geometric proportion, it is hurting people where I come from.

So I am so sick of this self-righteous sheen put on anybody who wants to tighten up bankruptcy is really anti-debtor. People are getting hurt, people are getting hurt. Again, I very much want to work out the two big provisions relating to Chuck's initiative—and I give him great credit for that—and also on your initiative, which is homesteading. We ought to be able to force this issue.

So my message to the creditors out there who want this tightened up is get on the team, join the band wagon, put as much pressure on the folks who won't do that as you put on people who are opposed to any change. I hope that message goes out clearly.

The second piece of this is there has got to be a way—Brady, if you are right, and if you are right, Judge, that on the extreme, at the end of the day, even though we put women and children first, like in sinking ships—even if they are first, there ought to be a way where we can make them the first among equals.

And we are not putting any new categories of debt in here, but maybe as we expand categories, and marginally, I might add, marginally—as we expand those categories, maybe we can still come up with a provision that says women and children cannot, even after they fail in 13, be subject to it, or even after they lose their job.

I find that one a hard one, Judge. I was a family court lawyer. I did these things. I wasn't a big-time lawyer. I was just a plain old trial lawyer, and I spent a lot of time as a public defender and a lot of time in family court going after those support payments and going after that stuff.

I didn't know anybody I ever ran across in my experience who would quit their job, because this legislation exists, in order to spite their circumstances than would do it now. I mean, I find that a real leap. But I hope there is a good-faith way we can try to fine-tune this, if you still think you have got to fine-tune it.

But something is wrong with a system that allows guys like me getting out of law school discharging our law school debt front-end, guys like me getting out of medical school discharging their medical school debt.

Judge NEWSOME. You would never be able to do that.

Senator BIDEN. Like heck you can't.

Judge NEWSOME. Not under this system you can't, not the one we have got right now. You can't get out of a medical debt. It is a HEELS loan most of the time, and you can't get out of those for love or money.

Senator BIDEN. By the way, that is not the only debt people acquire going through school.

Judge NEWSOME. And as to the law school debt, if those are educational loans, those are presumed non-dischargeable.

Senator BIDEN. No, no, they are not educational loans. I graduated $100,000 in debt and they were commercial loans. I didn't get one of those. I didn't qualify. My sons still have $120,000 they are paying off. You are full of malarkey, Judge.

Judge NEWSOME. They probably still would be under the statute.

Senator BIDEN. Well, then I had better let my sons know that. Maybe they can get moving before this gets changed.

[Laughter.]

Senator BIDEN. Anyway, I just think this is—

Judge NEWSOME. By the way, there is a new category of debt. It is 523(a(19) and it deals with loans that you take from your pension plan.

Senator BIDEN. Protected?

Judge NEWSOME. No, non-dischargeable.

Senator BIDEN. Non-dischargeable. That is what I mean.

Judge NEWSOME. OK.

Senator BIDEN. And that wasn't pushed by creditors, by the way.

Judge NEWSOME. I think it is a good provision.

Senator BIDEN. I do, too, and the other one, drunk driving, is too, and this one is, too. Anyway, I just hope we get a little bit of sanity into this debate here and stop the games.

Senator SESSIONS. I thank the Senator.

Senator BIDEN. Thank you.

Senator SESSIONS. The Senator from New York.

Senator SCHUMER. Thank you, Mr. Chairman. First, I want to thank my colleague from Delaware not only for the passion which he brings to this—we disagree on some of the issues—but particularly for his understanding of why the amendment I am proposing is so important, which you brought out, Ms. Vullo.

I certainly would hope that we could get people to accept at this time his call for the creditor community to use their suasion with people who have opposed this amendment. It would be very helpful because we do have majority support. It is simply that we couldn't get it through because a few people didn't want it to be part of it.

Coming from New York, of course, I get lots of calls from people who want this bill, heads of big financial institutions, and they say can't you withdraw your amendment? I say, well, if you get your wife to call me, I might consider that. Not a single wife has called me because they know that our amendment is the right amendment.

I just wanted to clarify a couple of things with Ms. Vullo. Let's just go over the sense of time that it has taken you to do this.

First, how long did it take you to litigate the Nuremberg Files case, start to finish?

Ms. VULLO. From October 1995—the jury verdict was February 2, 1999, so 3½ years before trial and verdict.

Senator SCHUMER. OK, and now how many more years has it taken with bankruptcy?

Ms. VULLO. It is now 2 years, last week.

Senator SCHUMER. Have your plaintiffs collected a nickel?

Ms. VULLO. A little bit more than that, a couple of thousand dollars by a garnishment of a corporate entity, not from any of the individuals because the individuals filed for bankruptcy when the—

Senator SCHUMER. So in none of the individual cases have they gotten any money yet?

Ms. VULLO. That is correct.

Senator SCHUMER. And if this group whom you represented—if the plaintiffs didn't have a top-notch pro bono lawyer, what do you think would have happened?

Ms. VULLO. I don't think the case would have been brought in the first instance, which is another reason, Senator, for why the amendment to the Bankruptcy Code relates very directly to the importance of the FACE statute itself, because you won't bring the FACE claim if you know that they are just going to, after the verdict, file for bankruptcy.

Senator SCHUMER. Right, and the amount of money in most of the settlements and judgments so far—yours is a particularly notorious case—would not compensate a lawyer even on a contingency fee basis in general. Is that right?

Ms. VULLO. That is correct.

Senator SCHUMER. Thank you, Mr. Chairman.

Senator SESSIONS. On the question of reaffirmations, I was asked to meet, Mr. Williamson, with Senator Reid, the White House and the Department of Justice. We hammered out reaffirmation language that did have some political give-and-take in it. It is not perhaps law review style, but it satisfied the Department of Justice and the Clinton White House, and it provided more protections, as Senator Biden said, clearly than were in existence before the law.

Senator BIDEN. Would you yield for a question? Didn't the White House push this?

Senator SESSIONS. Yes, they pushed this kind of language and we agreed to it.

Senator BIDEN. Brady has always been to the left of Clinton anyway, so it doesn't matter.

Senator SESSIONS. But more than that, reaffirmation is nothing but one of these arguments, in my view, that has nothing to do with it of importance here fundamentally. A person can go out and buy a room full of furniture or a washing machine and he or she signs a note at whatever interest rate the parties agree to. There is no lawyer present most of the time under those circumstances. Instead they sign it, and that is it.

But under bankruptcy law, they do have lawyers and the lawyer signs off on the reaffirmation. So at least they have had legal counsel. But that is not enough. They want to have the judge approve it. So we provided a method in which the information is provided to the judge and some standards that would say that if it was unfair or abusive to the debtor who is reaffirming the debt so they could keep the washing machine, there would be less problems. I think we made a good stop without creating a hearing for every doggone reaffirmation that goes on.

Mr. Williamson, the Bankruptcy Commission never formally voted on a means test, is that correct?

Mr. WILLIAMSON. That is correct, Senator.

Senator SESSIONS. And they didn't take a formal position on it one way or the other?

Mr. WILLIAMSON. That is correct, Senator.

Senator SESSIONS. With regard to homestead, it is an area of abuse, in my view, and I believe that bankruptcy law is Federal law. It is provided for in the U.S. Constitution and bankruptcy court judges are Federal judges.

Now, I am a States'-righter, and sometimes Senator Biden is a fierce States'-righter, too. This is a Federal law that is litigated in Federal court, but somewhere along the line Congress decided it couldn't reach an agreement on what the homestead limitations ought to be, so they punted it to the States and let the States decide what homestead limits would be. Some said none, and as a result people have the ability of abusing the system, while other States have set varying limits.

I don't think it violates States' rights to do so, but our Senators from Kansas and Texas and Florida and some other States have even agreed to the homestead fix contained in this bill—note that these laws override their States' laws, even their constitutions. Despite that's though, we were able to work out a solution that they were amendable to and that was fairer to everyone involved. So we have made substantial progress in eliminating abuses. If somebody ran from Mobile to Pensacola, and filed bankruptcy within 2 years, they could not protect but $100,000 of equity in their home.

Also, we provided that you could go back 7 years if you could establish an abuse scheme—and it is not always impossible to establish an abusive scheme—and then take that equity, except for $100,000.

Senator BIDEN. Mr. Chairman, I wonder how many people plan 2 years ahead of time they are going to declare bankruptcy before they declare it and that is why they buy the home. I mean, that is a lot of foresight. That is pretty good.

Senator SESSIONS. But if they did it by calculation and deviousness and delayed it for 2 years, then you could still go back under the fraud exception. So I think we made real progress in homestead.

I think the benefits for children and alimony are clearly superior, and I believe that justice in America must hold that a person who is making an average income in America and who can pay at least a part of his or her debts ought to pay them. Some say, well, we don't want to pay medical debts, but hospitals are people, too, in a sense. They serve people, they have needs.

Why should somebody who is capable of paying a part of their hospital bill, pay nothing? Other people work very hard to pay their hospital bills and sacrifice to maintain good insurance. Oftentimes, it is an irresponsible person who wants to ride on the responsible person.

I think bankruptcy, at its core, has the potential to be unfair to the responsible American citizen. That is who we most should affirm, the one who does right. We do allow, however, historically—and there will be no problem in this quarter—to maintain the right of a person in need who cannot pay his or her debts to wipe them out completely. That is not being changed. The needs-based issue is important for justice, basic morality and fairness. If a person can pay, they should pay.

Senator BIDEN. Mr. Chairman, would you yield me 60 seconds?

Senator SESSIONS. Yes.

Senator BIDEN. I want to make two points. With regard to the safe harbor provisions in here, just to set the record straight, I didn't draft this bill. This is not my subcommittee. I did not get involved in this. But when it was pointed out to me over a year ago that there was concern about poor people being subject and women and children being at the end of the line, I asked for a meeting with some of the largest creditors out there.

I told them that I wouldn't support this legislation unless there was a safe harbor provision put in and women and children went to the head of the line, expecting there to be an argument. Not one single bit of opposition; total, immediate support; zero opposition, none. One of them representing a large non-Delaware credit card company made the following comment: we don't want to be put in the position where we are going after so little money for so high a public relations cost, we don't want any part of that. So I just hope people understand that piece.

The second piece is I want to make the point I was for States' rights in *Bush* v. *Gore* and I don't know what happened.

Thank you.

Senator SESSIONS. Let me say this. Thank you all. It was an excellent discussion. As you can tell, we have discussed many of these issues before. They have been wrestled with, and sometime in the sausage-making process of laws being passed, certain compromises get made.

I must say, finally, Dr. Manning, on credit cards, that is really a banking issue. What kind of regulations should be placed on a credit card company offering credit to a poor person is really, I think, not part of creating a Federal system of bankruptcy law. I think we should be cautious about what we do in that regard.

In fact, the Chairman of the Banking Committee has asserted aggressively his belief that this is outside of our jurisdiction. So I think fundamentally concerns about credit cards should be directed to that committee. I would not want to pass a law that made it more difficult for a poor person to be able to get a credit card, because if they don't have ready cash and they are on the margin—anytime they have a flat tire, for example, and can't afford to fix their care without credit, that would be a bad thing. Credit cards are not evil things, per se. They have great advantages in many circumstances for poor people, and I would just caution everyone to remember that.

Senators Grassley and Kennedy have submitted written statements which we will include in the record.

[The prepared statements of Senators Grassley and Kennedy follow:]

STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator Sessions, thank you for chairing this hearing on bankruptcy reform, which we all consider to be unfinished business from the 106th Congress. As you know, the issue of bankruptcy reform is familiar to all of us here in the Senate. For the past 4 years, we've debated the fundamental rights of both borrowers and creditors, for the greater good of individuals, society, and the economy. We've looked at this issue at great length an in excruciating detail. The Judiciary Subcommittee on Administrative Oversight and the Courts held, I believe, eleven hearings over the past two Congresses, and heard testimony from almost 90 witnesses on all aspects of bankruptcy. We debated bankruptcy reform extensively on the floor in both the 105th and 106th Congresses, and last December we passed a bipartisan, compromise bill by a vote of 70 to 28. That piece of legislation received overwhelming support of Senators on both sides of the aisle.

Unfortunately, President Clinton pocket-vetoed that good legislation, and we here in the Senate did not have the opportunity to override it. We had the votes to do so. That was too bad, because we need bankruptcy reform. But I'm hopeful that we'll be able to move swiftly in this Congress and get the job done. That is why Senators Hatch, Sessions and Johnson joined me in reintroducing the exact same conference report that was approved by the Senate with overwhelming bipartisan support. I know many other members on both sides of the aisle support this bill and want to see it passed into law.

I repeat, this bill is unfinished business. This is not new stuff. We are not covering new ground. In fact, we don't even need to be in Committee. But in the interest of addressing Senator Leahy's concerns that new Senators on the Committee have a chance to familiarize themselves with this issue, we're holding this hearing today with the hope of proceeding quickly to this bill on the floor.

The current bankruptcy system needs to be reformed. Presently, when individuals file for bankruptcy under Chapter 7, a court proceeding takes place, and their debts are simply erased. We must realize that every time a debt is wiped away through bankruptcy, someone loses money. When someone loses money in this way, he or she has to decide to either assume the loss as a cost of business, or raise prices for other customers to make up that loss.

When bankruptcy losses are infrequent, lenders can just swallow the loss. But when they are frequent, lenders need to raise prices to other consumers to offset their losses. These higher prices translate into higher interest rates for future borrowers. You'll recall that former Treasury Secretary Larry Summers—a liberal Democrat—testified before the Senate Finance Committee that bankruptcies tend to drive up interest rates. With the possibility of the economy slowing down, we need to fix a bankruptcy system that inflates interest rates and threatens to make a slowdown even worse. Bankruptcy reform will help the economy.

So, the result of the bankruptcy crisis is that hardworking, law abiding Americans have to pay higher prices for goods and services. S. 220 would make it harder for individuals who can repay their debts from filing bankruptcy under Chapter 7, thus lessening the upward pressure on interest rates and higher prices. It's only fair to require people who can repay their debts to pull their own weight. But under current bankruptcy law, one can get full debt cancellation in Chapter 7 with no questions asked. Our bill asks the question of whether repayment is possible by an individual, and if it is, then he or she will be channeled into Chapter 13 of the Bankruptcy Code, which requires people to repay a portion of their debt as a pre-condition for limited debt cancellation.

Let me be clear, people who don't have the ability to repay their debt can still use the bankruptcy system as they would have before. S. 220 specifically provides that people of limited income can still file under Chapter 7. But the bill makes it so that people who have higher incomes and who can repay their debts, their free ride is over.

Personal responsibility has been one of the main themes of the bankruptcy reform bill. I say this because since 1993, in the midst of prosperity and with a booming economy, the numbers of Americans who declared bankruptcy has increased over 100 percent. While no one knows all the reasons underlying the bankruptcy crisis, the data shows that bankruptcies increased dramatically during the same time frame when unemployment was low and real wages were at an all-time high. I believe that the bankruptcy crisis is a moral crisis. We need to stop people from looking at bankruptcy as a convenient financial planning tool where honest Americans will have to foot the bill.

So, it is clear to me that our lax bankruptcy system must bear some of the blame for the bankruptcy crisis. A system where people are not even asked whether they can pay off their debts obviously contributes to the fraying of the moral fiber of our nation. Why should people pay their bills when the system allows you to walk away with no questions asked? Why should people honor their obligations when they can take the easy way out through bankruptcy? I think the system needs to be reformed because this is fundamentally unfair. Our bankruptcy reform bill will promote personal responsibility among borrowers and create a deterrence for those hoping to cheat the system.

Our bill does more than just provide for a flexible meanstest that gives judges discretion to consider the individual circumstances of each debtor to determine whether they truly belong in Chapter 7. It also contains tough new consumer protections, like new procedures to prevent companies from using threats to coerce debtors into paying debts which could be wiped away once they are in bankruptcy. The bill requires the Justice Department to concentrate law enforcement resources on enforcing consumer protection laws against abusive debt collection practices. The bill contains significant new disclosures for consumers by mandating that credit card companies provide key information about how much they owe and how long it will take to pay off their credit card debt by only making a minimum payment. Consumers will also be given a toll-free number to call where they can get information about how long it will take to pay off their own credit card balances if they make only the minimum payments. This will educate consumers and improve consumers' understanding of their financial situation. And credit card companies that offer credit cards over the internet will be required for the first time to fully comply with the Truth in Lending Act.

Moreover, our bill makes changes which will help particularly vulnerable segments of our society. Child support claimants are given the highest priority when the assets of a bankruptcy estate are distributed to creditors. Bankruptcy trustees and creditors of bankrupts will be required to give information about the location of deadbeat parents who owe child support.

I also want to touch on another important section of the bill. S. 220 makes Chapter 12 of the Bankruptcy Code permanent. This means that America's family farms are guaranteed the ability to reorganize. But the bill goes further. It makes improvements to Chapter 12 so it will be more accessible and helpful for farmers. For example, the definition of the family farmer is widened so more farmers can qualify for Chapter 12 bankruptcy protection. S. 220 also reduces the priority of capital gains tax liabilities for farm assets sold as a part of a reorganization plan, which will allow cash-strapped farmers to sell livestock, grain, and other farm assets to generate cash flow when liquidity is essential to maintaining a family farm operation. These reforms will make Chapter 12 even more effective in protecting America's family farms during difficult times. I think it's a crying shame that the opponents of bankruptcy reform have prevented Chapter 12 from being reauthorized and modernized. It was an outrage that President Clinton pocket-vetoed the bankruptcy bill and denied the farmers in my state of Iowa and across the country the bankruptcy protections they really need.

Over the last ten years our economy has enjoyed unprecedented success. But as we have seen, economic stagnation can occur just as quickly as an upswing. On a macro-economic level, enacting bankruptcy reform will help stimulate the economy by lessening upward pressure on interest rates. So, by passing meaningful bankruptcy reform, we can help our economy and simultaneously contribute to rebuilding our nation's moral foundations. I look forward to hearing from our witnesses this morning.

Statement of Hon. Edward M. Kennedy, a U.S. Senator from the State of Massachusetts

I welcome this hearing to consider this important issue once again.

In the past four years, supporters and opponents of bankruptcy legislation have disagreed many times about this legislation. Many of us feel strongly that Congress should not pass sweetheart legislation for the credit card industry. We do need to pass a bill to reduce fraud and abuse—but it should also maintain the long-standing safety net for vulnerable Americans who deserve it. Scores of bankruptcy scholars, advocates for women and children, labor unions, consumer advocates, and civil rights organizations agree with our position.

For weeks, President Bush has warned the nation about the potential problems of the current economic downturn. Pointing to layoffs and rising unemployment, decreasing consumer confidence, and low economic growth, President Bush is urging

Congress to pass legislation to strengthen the economy. But punitive bankruptcy reform legislation doesn't fall in that category. Now more than ever, we need to ensure that Americans losing their jobs or struggling with medical debt have the second chance for economic security that bankruptcy laws are intended to provide. This is especially no time to pull the rug out from under them.

We know the circumstances and market forces that often push middle class Americans into bankruptcy.

A rising unemployment rate and company layoffs are a major part of the problem. The slowing economy led to an unemployment rate of 4.2% in January—the highest level in 16 months—and every week brings reports of new layoffs that may well lead to bankruptcy for many families in coming months.

Divorce is another major cause of bankruptcy. Divorce rates have soared in recent decades—and the financial consequences are particularly devastating for women. Divorced women are four times more likely to file for bankruptcy than married women or single men. In 1999, 540,000 women—540,000—who head their own households filed for bankruptcy to try to stabilize their lives. 200,000 of them were also creditors trying to collect child support or alimony. The rest were debtors struggling to make ends meet.

Another major factor in bankruptcy is the high cost 43 million Americans have no health insurance, and many more are under-insured. Each year, millions of families spend more than 20 percent of their income on medical care. Older Americans are hit particularly hard. A 1998 CRS Report states that even though Medicare provides generally good health coverage for older Americans, half of this age group spend 14 percent or more of their after-tax income on out-of pocket health costs, including insurance premiums, co-payments and prescription drugs.

These Americans are not cheats and frauds—but they do constitute the vast number of Americans in bankruptcy. Two out of every three bankruptcy filers have an employment problem. Two out of every five bankruptcy filers have a health care problem. Divorced or separated people are three more likely than married couples to file for bankruptcy. Yet, the credit card industry and the Republican Congress determined to deny them the bankruptcy safety. net in order to ensure larger and larger profits for itself.

This legislation is an undeserved windfall for one of the most profitable industries in America. Credit card companies are engaged in massive and unseemly nation wide campaigns to hook unsuspecting citizens on credit card debt. They sent out 2.87 billion—2.87 billion—credit card solicitations in 1999. In recent years, the industry has even begun to offer new lines of credit targeted specifically at people with low income—even though the industry knows full well that these persons cannot afford to pile up such debt.

Supporters of the bill argue that it is not a credit card industry bill. But, to deal effectively and comprehensively with the problem of bankruptcy, we have to deal with the problem of debt. We must see that the credit card industry does not abandon fair lending policies to fatten its bottom line, or ask Congress to become the collector for its unpaid credit card bills.

Proponents of the bill also say that it ensures that alimony and child support will be the number one priority in bankruptcy. That rhetoric hides the complexity of the bankruptcy system—but it doesn't hide the fact that women and children will be the losers if this bill becomes law.

Under current law, an ex-wife trying to collect support has special protection. But under the pending bill, credit card companies are given a new right to compete with women and children for the husband's limited income after bankruptcy.

It is true that the bill moves support payments to the first priority position in the bankruptcy code. But that only matters in the limited number of cases where the debtor actually has assets to distribute to a creditor. In most bankruptcy cases—over 95 percent—there are no assets, and the list of priorities has no effect.

As 116 professors of bankruptcy and commercial law have stated, "Granting 'first priority' to alimony and support claims is not the magic solution the consumer credit industry claims, because 'priority' is relevant only for distributions made to creditors in the bankruptcy case itself. Such distributions are made in only a negligible percentage of cases. More than 95% of bankruptcy cases make NO distributions to any creditors because there are no assets to distribute. Granting women and children first priority for bankruptcy distributions permits them to stand first in line to collect nothing."

Similarly, thirty-one organizations that support women and children have stated, "Some improvements were made in the domestic support provisions . . . however, even the revised provisions fail to solve the problems created by the rest of the bill, which gives many other creditors greater claims—both during and after bankruptcy—than they have under current law."

This legislation unfairly targets middle class and poor families—and it leaves flagrant abuses in place. Any credible bankruptcy reform bill must include two important provisions—a homestead provision without loopholes for the wealthy, and a provision that requires accountability and responsibility from those who unlawfully—and often violently—bar access to legal health services. The current bill includes neither provision.

The bill does include a half-hearted loophole-filled homestead provision that will do little to eliminate fraud. With a little planning—or in some cases, no planning at all—wealthy debtors will be able to hide millions of dollars in assets from their creditors.

Last year, the Senate passed a worthwhile amendment to eliminate this inequity. But that provision was stripped from the conference report. Surely, a bill designed to end fraud and abuse should include a loophole-free homestead provision.

I urge my colleagues to stop peddling legislation to increase the profits of the credit card industry—already one of the most profitable industries in the country—at the expense of working families. It's time to pass true bankruptcy reform legislation that fairly balances the needs of both creditors and debtors.

I look forward to the testimony of today's witnesses.

Senator SESSIONS. We also have several letters and statements which have been submitted and we will include those in the record at this point.

The record will be open for further statements until Friday.

[The prepared statement and attachments of Senator Durbin and the prepared statement of Senator Thurmond follow:]

STATEMENT OF HON. RICHARD J. DURBIN, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Mr. Chairman, thank you for holding today's hearing on bankruptcy reform. Although we have debated bankruptcy legislation for several years, the last time I participated in hearings on the subject was in the 105th Congress, when I first served on this Committee. That was approximately three years ago. A lot has changed in three years.

Three years ago, bankruptcy filings were not only up, they had reached record setting levels. According to the Administrative Office of the U.S. Courts, there were 1,436,964 bankruptcy filings in fiscal year 1998, of which 1,389,839 (96.7%) were consumer bankruptcies. Now, three years later, bankruptcy filings are down.

In fact, the 1998 numbers seemed to be the peak. Bankruptcy filings—especially personal filings—dropped significantly in 1999—down to 1,315,751 personal bankruptcies—and dropped again in 2000, when the figure fell even further to 1, 226,037. That's 163,000 fewer personal bankruptcy filings in 2000 than in the peak year, 1998. This represents a 12% reduction in just two years.

Chapter 7 bankruptcies—"fresh start" filings—are coming down at an even faster pace, from 1,026,134 in 1998 to just under a million—959,292—in 1999, with a further decrease to 870,805 in fiscal year 2000—a 15% reduction in only two years.

Three years ago, I worked with Senator Grassley to develop a bipartisan balanced bankruptcy bill that addressed both irresponsible debtors and irresponsible creditors.

Ninety-seven Senators supported this bill and agreed to legislation that would have eliminated both debtor and creditor abuses while ensuring the availability of information that permits consumers to make informed financial decisions. Unfortunately, the bill was decimated in conference and I could not support it in the end.

This year, we have before us last year's bankruptcy bill. It is the same bill that, as written last year, failed to meet the basic test of fairness and balance. I opposed this unbalanced bill last year.

President Clinton recognized the lack of balance and wisely pocket vetoed the bill last Congress.

Our bill in the 105th Congress included debtor specific information that would enable cardholders to examine their current credit card debt in tangible terms, driving home the seriousness of their financial situation.

The bill before us today permits banks with less than $250 million in assets to have the Federal Reserve provide its customers with a tollfree phone number to review their credit card balances for the next two years. It is unclear whether the banks would be required to provide the service themselves after the two years are complete.

This exemption would cover 4,000 banks holding about $3 billion in consumer credit card debt. This is a departure from a balanced approach.

The bill also fails to close the homestead loophole. Under this bill, a renter or someone with less wealth will get to keep nothing, but a homeowner who has equity in her home that existed prior to the two year cut off can keep all the equity. By failing to include a hard cap, this provision only benefits the rich.

The current bankruptcy bill also fails to include an amendment sponsored by the senior Senator from New York, Senator Schumer, which would prevent documented abuse of the bankruptcy system by those who violate the Freedom of Access to Clinic Entrances Act (FACE) or an equivalent state law. In most cases where a defendant is held liable under the FACE Act, there is no finding that the action was "willful and malicious" and the FACE Act often includes acts which may not be classified as "acts of violence" (e.g., an act of intimidation or verbal harassment). Without Senator Schumer's amendment, this bill would continue to allow many perpetrators of clinic violence to seek shelter in the nation's bankruptcy courts.

For these reasons, although I am all for bankruptcy reform, I cannot support the bankruptcy bill in its current form. It is unbalanced.

One hundred and sixteen nonpartisan law professors also recognized this in their letter to Congress last year. In their letter, the law professors noted how "deeply flawed" the bankruptcy bill is and its adverse affect on women and children.

Mr. Chairman, I ask for unanimous consent that the letter from the 116 nonpartisan law professors be entered into the record.

Mr. Chairman, I just received a letter from the American Academy of Matrimonial Lawyers, also expressing their "deep concern" about the reintroduction of this bankruptcy bill. In it they say, "We believe that children should come before credit card companies." I ask unanimous consent that this letter also be entered into the record.

"Balance" is certainly the order of the day. We're in a new Congress, with a balanced, 50/50 Senate. We also have a new President, faced with the challenge of uniting an evenly-divided electorate. And we have a new and real opportunity to work together and pass balanced and meaningful bankruptcy reform.

While there are some positive aspects to this bill, we could, and we should, do much better. I look forward to working with my colleagues both here in this Committee and on the Senate floor to improve this bill and give all American people and businesses balanced meaningful bankruptcy reform.

HARVARD LAW
October 25, 2000

Re: The Bankruptcy Reform Act Conference Report (H.R. 2415)

Dear Senators:

We are professors of bankruptcy and commercial law. We have been following the bankruptcy reform process with keen interest. The 75 undersigned professors come to every region of the country and from all major political parties. We are not a partisan, organized group, and we have no agenda. Our exclusive interest is to seek the enactment of a fair and just bankruptcy law, with appropriate regard given to the interests of debtors and creditors alike, Many of us have written before to express our concerns about the bankruptcy legislation, and we write again as yet another version of the bill comes before you- This bill is deeply flawed, and we hope the Senate will not act on it in the closing minutes of this session.

In a letter to you dated September 7, 1999, 82 professors of bankruptcy law from across the country expressed their gave concerns about some of the provisions of S. 625, particularly the effects of the bill on worsen clad children. We wrote again on November 2, 1999, to reiterate our concerns. We write yet again to bring the same message: the problems with the bankruptcy bill have not been resolved, particularly those provisions that adversely affect women end children.

Notwithstanding tire unsupported claims of the bill's proponents, H.R. 2415 does not help women and children. Thirty-one organizations devotee! exclusively to promoting the best interests of Women; and children continue to oppose the pending bankruptcy bill. The concerns expressed in our earlier letters showing how S. 625 would hurt woman and children have not been resolved. Indeed, they have not event been addressed.

First, one of the biggest problems the bill presents for worsen and children was stated in tile September 7, 1999, letter:

"Women and children as creditors will have to compete with powerful creditors to collect their claims after bankruptcy,"

This increased competition for women and children will come from many quarters: from powerful credit card issuers, whose credit card claims increasingly will be excepted from discharge and remain legal obligations of the debtor after bankruptcy; from large retailers, who will have an easier tinge obtaining reactions of debt that legally could be discharged; and from creditors claiming they bold security, even when the alleged collateral is virtually worthless. Atone of the changes made to S. 625 and none being proposed in H.R. 2415 addresses these problems. The truth remains: if H.R. 2415 is enacted in its current form, women, and children will face increased competition in collecting their alimony and support claims after the bankruptcy case is over. We have pointed out this difficulty repeatedly, but no charge has been made in the bill to address it.

Second., it is a distraction to argue- as do advocates of the bill—that the bill will "help" women and children—and that it will "make child support and alimony payments the top priority—no exceptions." As the law professors pointed out in the September 7, 1999, letter:

"Giving 'first priority' to domestic support obligations does not address the problem."

Granting "first priority" to alimony and support claims is not the magic solution the consumer credit industry claims because 'priority" is—relevant only for distributions made to creditors in the bankruptcy case itself. Such distributions are made in only a negligible percentage of cases. More than 95% of bankruptcy cases make NO distributions to airy creditors because there are no assets to distribute. Granting women and children a first priority for bankruptcy distributions permits them to stand first in line to collect nothing.

Woman's hard-fought battle is. over reaching the ex-husband's income after bankruptcy. Under current law, child support and alimony share a protected post-bankruptcy position with only two other recurrent collectors of debt-taxes and student loans. The credit industry asks that credit card debt and other consumer credit share that position, thereby elbowing aside tile women trying to collect on their own behalf. The credit industry carefully avoids discussing the increased post-bankruptcy competition facing women if H.R. 2415 becomes law. As a matter of public policy, this country should riot elevate credit card debt to the preferred position of taxes and child support. Once again, we have pointed out this problem repeatedly, and nothing has been changed in the pending legislation to address it.

In addition to the concerns raised on behalf of the thousands of women who are straggling now to collect alimony and child support after their ex-husband's bankruptcies, we also express our concerns on behalf of the more than half a million women heads of household who will file for bankruptcy this year alone. As the heads of the economically most vulnerable families, they have a. special stake in the pending legislation. Women heads of households are now the largest demographic group in bankruptcy, and according to the credit industry's owndata, they are the poorest. The provisions in this bill, particularly the many provisions that apply without regard to income, will fall hardest on them. Under this bill, a single mother with dependent children who is hopelessly insolvent and whose income is far below the national median income would have her bankruptcy case dismissed if she does not present copies of income tax returns for the past three years—even if those returns are in the possession of her ex-husband. A single mother who hoped to work through a chapter 13 payment plan would be forced to pay every penny of the entire debt owed on almost worthless items of collateral, such as used furniture or children's clothes, even if it meant that successful completion of a repayment plan was impossible.

Finally, when the Senate passed S. 625, we were hopeful that the final bankruptcy legislation would include a meaningful homestead provision to address flagrant abuse in the bankruptcy system. Instead the conference report retreats from the concept underlying the Senate-passed homestead amendment.

The homestead provision in the conference report will allow wealthy debtors to hide assets from their creditors.

Current bankruptcy law yields to state law to determine what property shall remain exempt from creditor attachment and levy. Homestead exemptions are highly variable by state, and six states (Florida, Iowa, Kansas, South Dakota, Texas, Oklahoma) have literally unlimited exemptions while twenty-two states have exemptions of $10,000 or loss. The variation among states leads to two problems—basic inequality and strategic bankruptcy planning- The only solution is a dollar cap on the homestead exemption. Although variation among states would remain, the most outrageous abuses—those in the multi-million dollar category—would be eliminated.

The homestead provision in the conference report does little to address the problem. The legislation only requires a debtor to wait two years after the purchase of the homestead before filing a bankruptcy case. Well-counseled debtors will have no problem timing their bankruptcies or tying-up the courts in litigation to skirt the intent of this provision. The proposed change will remind debtors to buy their property early, but it will not deny anyone with substantial assets a chance to protect property from. their creditors. Furthermore, debtors who are long-time residents of states like Texas and Florida will continue to enjoy a homestead exemption that can shield literally millions of dollars in Value.

These facts are unassailable: H.R. 2415 forces women. to compete with sophisticated creditors to collect alimony and child support after bankruptcy. H.R. 241.5 makes it harder for women to declare bankruptcy when they are in financial trouble. H.R. 2415 fails to close the glaring homestead loophole and permits wealthy debtors to hide assets from their creditors. We implore you to look beyond the distorted "facts" peddled by the credit industry. Please do not pass a bill that will hurt vulnerable Americans, including women and children.

Thank you for your consideration.

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AMERICAN ACADEMY OF
MATRIMONIAL LAWYERS
CHICAGO, ILLINOIS 60601
February 7, 2001

Senator Edward M. Kennedy
315 Russell Senate Office Building
United States Senate
Washington, DC 20510

Representative Jerald Nadler
B336 Rayburn House Office Building
United States House of Representatives
Washington, DC 20515

Dear Senator Kennedy and Representative Nadler;

As president of the American Academy of Matrimonial Lawyers (AAML), I am writing to express the deep concern of the Academy over the re-introduction and fast-tracking of the bankruptcy "reform" legislation 5.220 and H.R.333 and it's adverse effect on children and families receiving child support payments.

The Academy believes credit card debts should retain their unsecured status, because their nondischargeability will affect the debtor's ability to pay child support, alimony and property settlements.

The bill as written will change existing law in a way that is extremely harmful to women and children. While at first reading it appears that.support payments have "priority," the reality is that protection exists only for a limited amount of time.

In a Chapter 7 case the non-dischargeability of the credit card debt will mean that the debtor does not truly have a "fresh start' and will be unable to pay all his remaining obligations; most specifically support obligations and potentially a property settlement payment.

In a Chapter 13 case the credit card debts are treated equally with support obligations when devising a payment plan, .thus the support obligationreceives.a pro-rata payment only while under existing law they have a priority.

We believe that children should come before credit card companies.

We urge the defeat of this legislation.

Respectfully yours,

CHARLES C. SHAINBERG

STATEMENT OF HON. STROM THURMOND, A U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA

Mr. Chairman:

I am pleased that we are holding this hearing today on bankruptcy reform.

There is a great need to reform our Bankruptcy Code to address the abuse of the system that is widespread today. At one time in America, the vast majority of people were determined to pay their debts and there was a stigma attached to filing for bankruptcy. However, today, filing for bankruptcy is much more accepted in society, and it has become much more routine, even in the booming economy of recent years.

In 1999 alone, about 1.4 million Americans filed for bankruptcy. These numbers represent more than a four-fold increase in the past twenty years. The huge number of filings is a serious, national problem that effects all Americans. We cannot allow bankruptcy to be used as a tool for financial planning.

The Bankruptcy Reform Act, which passed the Congress last year and has already been reintroduced, would target the abuses. The bill would require people to reorganize their debts when they can afford to repay them. It would prevent the much too common practice today of people choosing to discharge their debts in bankruptcy rather than repay what they can over time.

In addition, the bill contains special provisions to protect women who depend on child support to provide for their families. It would make child support payments the top priority for payment in bankruptcy.

Finally, the bill would reauthorize many important bankruptcy judgeships, including one in my home state of South Carolina, and make special bankruptcy protections for farmers permanent in the law.

The problems in bankruptcy are not new, and neither are our efforts to solve them. In recent years, this Committee has held numerous hearings and has extensively debated legislation to provide comprehensive, needed changes to the current outdated system. The Bankruptcy Reform Act that we passed late in the last Congress was a good, compromise bill. It passed both houses of the Congress by wide margins with bipartisan support. Unfortunately, President Clinton chose not to sign the bill. However, I am confident that the current Administration will be more receptive to the Congress's bankruptcy reform agenda.

I hope the new Congress can act quickly on this critical legislation. It is a serious problem that must be addressed without further delay.

We are adjourned.

[Whereupon, at 12:46 p.m., the committee was adjourned.]

[Questions and answers, and submissions for the record follow:]

[Additional material is being retained in the Committee files.]

QUESTIONS AND ANSWERS

Responses of Philip L. Strauss to Questions from Senator Biden

DEPARTMENT OF CHILD SUPPORT SERVICES
San Francisco, CA 94105

Hon. Joseph R. Biden, Jr.
Senate Judiciary Committee
U.S. Senate
Dirksen Senate
Building, Room 224
Washington, D.C. 20510

ATTN: Kristen A. Cabral, Esq.

Re: Response to Memorandum of the National Bankruptcy Conference: Erosion of the Discharge and the Myth of "Special Protection" for Domestic Support Obligations

Dear Senator Biden:

On February 21, 2001 a facsimile transmission was received by my office requesting a response to a memorandum of the National Bankruptcy Conference entitled "Erosion of the Discharge and the. Myth of Special Protection" for Domestic Support Obligations. I was attending a conference the week this request was received so I am submitting the answers somewhat late. I apologize for the delay.

In three and one-half single spaced pages the memorandum made two points. One, that giving first priority status to domestic support obligations will have little effect on collecting support. The argument made is that to have an effect the estate must have assets and the vast majority of cases filed are no asset Chapter 7 cases. The second point was that support creditors would be severely hampered in their efforts to collect support after bankruptcy because of the existence of debt which was previously dischargeable

In answer to the first issue I make three points:

1. The "vast majority of cases" in general appears not to reflect the profile of domestic support cases. It has been said that 95% of bankruptcy petitions filed are no asset Chapter 7. cases. I ask whether anyone has attempted to profile the typical domestic relations debtor to determine what percentage of this population files Chapter 13 cases (which, by definition, have assets) as opposed to Chapter 7 cases?

This morning I had our office run a report of all bankruptcy cases in the San Francisco Department of Child Support Services. The results indicated that 530 of the bankruptcy cases on our system are Chapter 13 cases. Thus, among child support debtors, 53% of the cases have assets. I cannot believe that San Francisco differs that much statistically from the general support-debtor population which files bankruptcies.

This result is not surprising to me since I see every bankruptcy case coming into my office and know that a very high percentage are Chapter 13 filings. Since support debtors have already been found to have the ability to pay support by a domestic relations court, it is not unreasonable to conclude such debtors have assets to protect and therefore file under Chapter 13 more frequently than the population at large. And, lest we forget, S. 220 will require a greater percentage of bankruptcy debtors to file Chapter 13 cases, thus substantially increasing the use of support enforcement enhancements of S. 220 to collect support.

2. Priority for all child support debts is enormously important in Chapter 13 cases. Since a debtor in a Chapter 13 case must repay all arrears during the term of the Chapter 13 plan, unless the creditor agrees otherwise, the priority status will insure that, to the extent feasible, all debts in the nature of support will be paid. Thus, the distribution of assets to priority creditors is not illusory at all.

In addition S. 220 makes all support debts enforceable against the debtor's exempt property. Thus, support creditors may be able to satisfy their support obligations even in no asset cases when the debtor has exempted property from the estate.[1]

3. Enormous benefits for support creditors, other than receiving first priority are contained in the bill. The National Bankruptcy Conference memorandum did not address the various and considerable benefits support creditors receive in other sec-

[1] See the amendment to 11 U.S.C. § 522(c)(1) contained in section 216 of the bill.

tions of the bill. Section 212 deals with priorities, but other provisions do a great deal more good than section 212.

a. Section 213 prevents confirmation of plans and discharge of debts when postpetition support is not paid in full.

b. Section 214 excepts numerous support collection devices from the reach of the automatic stay, thus allowing support collection to proceed without interruption from the bankruptcy stay.

c. Section 215 prevents the discharge of non-support divorce debts, which in far too many cases are necessary for the maintenance and well-being of an exspouse.

d. Section 216 prevents the debtor from removing liens securing support from his property and subjects the debtor's exempt property to the enforcement of support debts.

e. Section 217 prevents the recovery by the trustee of support payments actually paid by the debtor to the support creditor before the bankruptcy was filed.

f. Section 219 requires the trustee to provide important notice to support creditors in order to insure that their debts will be collected.

All in all, criticizing this bill because the priority provision in section 212 in not helpful is like burning down a house because the chimney doesn't work. But the chimney does work here. While the priority status in Chapter 7 cases may not provide wide spread benefits, it certainly will in Chapter 13 cases.

The second issue raised by the memorandum is that, with all this'newly non-dischargeable-debt, support will be harder to collect. No professional support collector sees the existence of newly nondischargeable debt as an impediment to support collection! The argument advanced is that credit card companies "are institutionally well suited to use the courts to collect their claims" while the ex-spouse is "not institutionally established to collect these debts." One wonders, of course, how cost effective it will be for a credit card company to use the courts in the first place to commence the collection process.

I submit, however, that if a support creditor wants the debt collected, this creditor will have to take some action to get the debt collected, unless the creditor wishes to rely on the good faith of the debtor to pay the debt voluntarily. In my experience this collection technique is nearly worthless.

The federal child support enforcement program[2] provides an easy solution to this problem for generally needy and dependent mothers. It is an institutionally established means to collect support debts after bankruptcy. It exists in every jurisdiction of every state in this country. It is provided free or for a nominal fee. And information regarding this service must, under section 219 of the bill, be provided to every support creditor by the bankruptcy trustee.

Once the support creditor obtains either private or government provided support collection assistance, the competitive advantages available to the support collector over financial institutions are staggering. For this reason I do not believe that credit card debt, either before or after bankruptcy, stands in the same. position as support debt with respect to its collectibility. Support collection advantages outside of (or after) bankruptcy competitively overwhelm financial institutions. For example the following post-bankruptcy collection advantages are available to support creditors, and not to credit card or other financial institutions:

a. Priority wage withholding to collect support. This advantage is stunning. It means that whenever a wage garnishment is filed by a support creditor, it will assume immediate priority over any other garnishment, no matter when filed. And since the S. 220 allows wage withholding to continue or be implemented after the bankruptcy has been filed, the collection of support in the normal case will never be held hostage to bankruptcy, before, during, or after the case is completed.

b. Interception of state and federal tax refunds to pay child support arrears.

c. Garnishment or interception of Workers' Compensation or Unemployment Insurance Benefits.

d. Free or low cost collection services, provided by the government.

e. Use of interstate processes to collect support arrearage, including interstate earnings withholding orders and interstate real estate liens.

f. Revocation or suspension of driver's, professional and recreational licenses of support delinquents.

g. Criminal prosecution and contempt procedures for failing to pay support debts.

h. Federal prosecution for nonpayment of support and federal collection of support debts.

[2] Social Security Act, Title IV–D, §§ 451–469 (42 U.S.C. 99651–669).

i. Denial of passports to support debtors.

j. Automatic treatment of support debts as judgments which are collectible under state judgment laws, including garnishment, execution, and real and personal property liens.

k. Collection of support debts from exempt assets.

While this list is not exhaustive, it is certainly illustrative of the vastly superior advantages of support creditors over commercial creditors. For these reasons I do not consider S. 220 as a mechanism for aggravating the problem of collecting post-bankruptcy support debts.

Agencies, such as mine, operating the federal child support enforcement program are funded in part by incentives based on collections. We would hardly be advocating a bill which had the potential of reducing post-bankruptcy collections and consequently funding incentives. It is for this reason that the following national organizations, whose membership consists mostly of persons employed in or funded by the federal support enforcement program, support this bill.

a. The National Child Support Enforcement Association

b. The National District Attorneys Association

c. The National Association of Attorneys General

d. The Western Interstate Child Support Enforcement Council

The National Child Support Enforcement Association, alone, represents over 60,000 child support professionals in this country. I attach their letter of support asking the President to sign last year's version this bill.

One final note. The National Bankruptcy Conference contrasts the 96% success rate in collection by credit card companies with the rather dismal support collection rate for women. On its face this statistic is absurd because it deals with two distinct populations. To be fair we would have to ask what the credit card company collection rate is for persons already in economic trouble and not paying support. What percentage of people owing child support even have credit cards. And since support agencies must report support delinquents to credit reporting agencies, persons with significant support debt will not be issued credit cards in the first place. What's more, even as to those "deadbeats" who could, but are not, paying support but who are paying credit card debt to retain their cards, I have the strongest doubts that they would commence paying their support debts simply because their credit card debt was extinguished. If history has any significance, those credit cards would simply be reloaded with consumer debt.

Therefore I am not at all impressed by the significance that the general credit card population pays its bills. I am more concerned that this comparison makes tacit assumptions which are just illogical, if not, in fact, dead wrong. The most ill advised assumption being the supposition that the payment characteristics of the general credit card population have any relevance to the general support debtor population.

I hope this letter answers the issues raised by the National Bankruptcy Conference. If you have any other questions please do not hesitate to contact me.

Yours very truly,

PHILIP L. STRAUSSS
PRINCIPAL ATTORNEY
Department of Child Support Services

cc. Hon. Orrin Hatch, Chairman, Senate Judiciary Committee

Responses of K.H. Beine to Questions submitted by Senator Feingold

SHORELINE CREDIT UNION
Two Rivers, WI 54241–0233

Jane Butterfield, Committee Liaison
US Senate Judiciary Committee

FROM: K H Beine

Re: Written Questions from Senator Russ Feingold, Bankruptcy Abuse Prevention Legislation

Question 1: Testimony focused on means test, reaffirmations and mandatory credit counseling. Reaction to other provisions of S. 220.

While my testimony focused on three specific issues as CUNA's priorities in S. 220, we recognize that the bill is the product of many years of debate and compromise. Because it is balanced between many interests, it is not perfect for any particular group. And because of that balance, CUNA is reluctant to pick apart individual parts of the bill at this stage of the legislative process.

I assume your question regarding the nondischargeability of credit cards refers to section 310 of the bill. This is a fairness issue. We are unusually careful with respect to granting credit including credit card limits. In addition we bend over backwards to assist members in trouble. Yet despite those efforts we often times loose along with everyone else when someone decides that it is no longer convenient to repay their debts. A debt is a debt. If the person has the ability to repay, then whether something was purchased on time payments or viii a check that bounces or via a credit card, the debt should be repaid.

Regarding your question on section 311 of the bill, credit unions are sympathetic to the needs of housing for people. There are practical difficulties, however, with this issue. Experience has shown that some people, as a planning tool, file bankruptcy just to stop eviction proceedings. Somehow this doesn't seem fair.

With respect to the provision on cramdowns, if it does not remain in the bill it would make auto credit terms for future borrowers that much tougher.

Question 2: Testimony regards Shoreline Credit Unions banlauptcy experience.

Before I answer your questions, I both have to commend you for your astute observation and apologize for an incorrect number on the Pact Sheet that accompanied the written testimony. Shoreline Credit Unions losses due to bankruptcy for the 2000 calendar year were $64,186.

Shoreline's losses due to bankruptcy are very low and are not material at the present time. However they have never the less doubled each of the last three years. And yes, (and I thank you for your kind comments) that is despite the fact that indeed we are careful lenders and do evaluate our loan applicants with great care.

So, doubling or not, if below the national average, why am I concerned? We can absorb one more doubling within our present operating cost structure. However if losses double twice rnore we will be at $250,000. That is hs1f our credit unions net earnings in recent years. Game over.

We are a $50M credit union. Our deposit base on average grows about 10% per year. Credit unions, like banks, have minimum regulatory capital requirements. However our earnings are our only source of additions to capital. We cannot sell stock to bring in outside capital as other financials. We therefore need to earn a ROA, Return on Assets, of approx 1.00% per year to maintain a reasonable 8–12% capital ratio. If losses reach the $250k mark as noted above, I will have no choice but to increase general loan interest rates to recover this "cost of doing business".

Who will pay those increased rates? Everyone to a certain extent, which is not fair, but for the most part those members who can least afford it. How will it be done? By applying "risk: lending" procedures, i.e. charging higher rates to those debtors who because of past credit problems and already high debt ratios present a higher risk and have a propensity to generate losses.

With respect to your position that perhaps the private sector could fix the current "bankruptcy crisis" with more careful lending, T do not believe that is possible. First of all the general "tightening" of credit across the country that would be necessary to accomplish that would, in my opinion, be detrimental to the economy. (And in all probability hurt many in the lower income areas who most need ready access to credit.) And second the comfortable and repeated use of bankruptcy as a financial management tool has become so pervasive that I do not think drat the private sector can stem the tide on its own.

Question 3: Reaffirmation agreements.

While credit unions continue to enjoy a substantially higher reaffirmation rate than other financial entities, the number of rations is on the decrease. For example, in our case, prior to the mid 1990's Shoreline enjoyed an almost 100% reaffirmation rate. Reaffirmations are now running approx 50%. Why the drop? Often times the debtor's anorney argues against reaffirmation or flat out refuses to sign the agreement. And it takes a rare individual, regardless of what we may have done for them; to voluntarily repay a debt that has been discharged.

CUNA has no objection to a standardized form that assures debtors are getting full disclosure. And credit unions, like all other creditors, will be required by the bill to provide a reaffirmation disclosure to their members who agree to reaffirm a debt that would otherwise be discharged in bankruptcy. This provision was added at the insistence of the Clinton Administration to address concerns about abusive and coercive reaffirmations.

But credit unions have not been found to be part of the problem, so S. 220 recognizes the unique relationship between credit unions and their members in negotiating reaffirmation agreements in good faith. Therefore, a reaffmnation agreement filed with the court between a member represented by counsel and the credit union will not have to include a specific schedule of income and expenses, and will never raise a presumption of an undue hardship for a credit union member reaffirming a credit union debt, which would be subject to review by the bankruptcy court. This exception for credit union reaffirmations is appropriate because credit unions don't seek reaffirmation agreements unless they feel the member is able to repay the loan and the member will benefit by receiving future financial services from the credit union, rather than have to seek them elsewhere at a steep premium.

Regarding the inquiry of whether abusive reaffirmation agreements would put credit unions at a disadvantage, we are confident that with the changes in this bill and with the numerous laws already on the books, there is ample protection for the consumer in this area. There are legal firms as well as the various consumer watchdog groups that stand ready, willing and able to make any transgressor pay an onerous price for noncompliance.

1 thank you for the opportunity to be able to assist you with respect to your position on this important legislation. Please contact me if you have any additional questions.

[*Note*: Revised Fact Sheet attached.]

FACT SHEET [REVISED 2–19–2001]

Total Assets:	$50.5 million (data as of December 2000).
Members:	11,700.
Total Loans:	38.0 million.

Losses Due to Bankruptcy:

2000	522,375	s/b $64,186	[khb 2/19/01]
1999	534,577		
1998	15,309		
1997	9,883		
1996	1,875		

Number of Filings:	Chapter 7	Chapter 13	Total
2000	10	0	10
1999	7	1	8
1998	5	0	5
1997	3	0	3
1996	1	0	1

Responses of Randall J. Newsome to Questions submitted by Senator Feingold

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
Oakland, California 94612

Senator Russ Feingold
506 Hart Senate Office Building
Washington, DC 20510–4904

Dear Senator Feingold,

This letter will serve as my response to the written questions you submitted to me on February 20, 2001. Your first question asks whether S. 220 "will essentially destroy Chapter 13 as an option for debtors who wish to keep their cars. . . " As I stated in both my written and oral testimony, I believe that the "anticramdown" provision in § 306(b) of the bill will destroy the incentive for many debtors to file a chapter 13 case. When § 306(b) is combined with § 314(b), which eliminates the enhanced discharge presently afforded by chapter 13, only those debtors seeking to save a home from foreclosure will find chapter 13 a reasonable option.

A hypothetical will illustrate why § 306(b) will hurt both debtors and creditors. Suppose in 1998 Mr. Jones, who is single and lives in an apartment, purchased a 1994 Dodge for $15,000 on credit. At the time he bought the car, its fair rnarket value was only $12,000, but because of his poor credit rating, he was forced to pay substantially over market Because he can't afford the payments on the Dodge along with his other monthly payments, he files a chapter 13 case in 2001. At the time he files, he still owes $10,000 on the car, and he has other unsecured debts totaling $4000. Without counting payments on his debts, his monthly income exceeds his monthly expenses by $240 per month. The real fair market value of the car at the time of filing is $5000. Under present law Mr. Jones could write down the value of the Dodge to $5000 in his chapter 13 plan. Assuming he proposes a plan to pay $240 a month over 36 months, be would be able to pay $5000 plus interest to the secured creditor, and repay a meaningful portion of his unsecured debt over the life of the plan. But under § 306(b) of S. 220, Mr. Jones would be forced to pay all $10,000 of the remaining contract price on the car, because he bought it within five years of filing his chapter 13 case. This is true even though the car is now 7 years old, and the creditor would get substantially less than its present value of $5000 if the car were repossessed and sold. Depending on the interest rate on the Dodge debt and the chapter 13 trustee's commission, Mr. Jones might not even be able to propose a plan that would pay off the car, pay nothing to his unsecured creditors, and be completed within the 60-month time limit for chapter 13 plans. He would be much better off allowing the secured creditor to repossess the lodge, tile a chapter 7 case, and attempt to buy a newer car, even though the interest rate undoubtedly would be exorbitant. 'thus, neither the secured nor the unsecured creditors are paid what they're owed, and the debtor is back in a debt trap. No one benefits.

Your second question concerns the problem of repeat filers. I view this as one of the most serious abuses of the bankruptcy system. It has been most severe in the Central District of California. Nonetheless, I would urge cautioxl in attempting to correct it. No one would seriously argue against amending the bankruptcy code to target those who file repeatedly just to stop a foreclosure or an eviction. But many repeat filers are forced to file a second petition because their first case was dismissed for reasons beyond their control, such as the incompetence of a bankruptcy petition preparer. I have read your proposed amendment to S. 220, and believe it strikes the appropriate balance. It protects the rights of imocent tenants, while preserving the right of a landlord to rid themselves of a bad tenant without the legal expense of seeking relief from the automatic stay in bankruptcy court.

Please don't hesitate to contact me if I can be of further assistance.

Very truly yours,

RANDALL J. NEWSOME

Responses of Philip L. Strauss to Questions submitted by Senator Feingold

DEPARTMENT OF CHILD SUPPORT SERVICES
San Francisco, CA 94105

Honorable Orrin G. Hatch, Chairman
Senate Judiciary Committee
U. S. Senate
Dirkson Senate Building, Room 224
Washington, D.C. 20510

ATTN: Jane Butterfield

Re: Questions Submitted By Senator Russ Feingold For Phillip L. Strauss

Dear Senator Hatch:

A facsimile transmission was received by my office requesting answers to three questions submitted by Senator Feingold February 22, 2001. I was attending a conference the week these questions were submitted so I am submitting the answers somewhat late.

Question 1. Are you aware that in 95% of bankruptcy cases there are no distributions to any creditors at all because there are no assets to distribute?

Answer: That statistic is generally considered to be accurate for Chapter 7 cases, which overall constitute about two thirds of all bankruptcy filings. However, in Chapter 7 the debtor's earnings, after he files bankruptcy, are not part of the distributions in the case. It is from those earnings that the spouse or children will normally receive their support payments. Therefore, that statistic is somewhat irrelevant for support collection purposes in Chapter 7 cases. In Chapter 13 cases, which comprise almost all of the remaining one third of bankruptcy petitions, the filings do directly affect the debtor's ongoing wages which are estate assets. The proposed amendments would specifically require that the debtor provide for full payment of ongoing support obligations and satisfaction of all arrears in order to have a plan confirmed, unless the spouse agrees otherwise.

In San Francisco our actual experience is quite different from the statistic you cite. This morning I had our office run a report of all bankruptcy cases in the San Francisco Department of Child Support. The results indicated that 530 of the bankruptcy cases our system are Chapter 13 cases. Thus, among child support debtors, 53% of the cases have assets. I cannot believe that San Francisco differs that much statistically from the general support-debtor population which files bankruptcies.

Chapter 13 cases give us the most trouble because of the severe collection limitations placed even on support creditors during bankruptcy. In Chapter 13 cases we truly are placed in unfavorable competition with other creditors and must wait until secured. creditors and administrative costs are paid before priority and then unsecured debts are paid. Much child support consists of general unsecured debts as of the petition date, and consequently it is the last paid, if paid at all. S. 220 will insure that all child support is treated as a priority debt, insuring its full payment during the term of a chapter 13 plan, as set forth above.

In addition, S. 200 would cause more debtors to file Chapter 13 cases and thus give support creditors the additional protections afforded by many of the child support provisions of the bill.

Question 2. Do you understand that this bill will elevate some unsecured credit card debt, namely a debt which is found to be nondischargeable and debt that is reaffirmed, to the same position after bankruptcy as child support and alimony?

Answer: I do not believe that credit card debt, either before or after bankruptcy, stands in the same position as support debt. Also, this bill does not change the relative position of support debt and reaffirmed debt, since discharged debt can now be reaffirmed.

In trying to determine whether the existence of postbankruptcy credit card debt will affect the collection of support debt adversely, I can only say that no professional support collector believes this to be a problem. Your question asserts that credit card debt will be "elevated" to the same position as support after bankruptcy. If by this statement you mean that some limited additional amount of debt may be held nondischargeable, in addition to the amounts that may already be so held, then you are correct. But support collectors have enormous advantages in collecting their debts, compared to other unsecured creditors in the nonbankruptcy arena. Nonsupport debts will not, however, be elevated to an equal collection status with support debts. As I have said many times, professional support collectors are not concerned with the existence of other debt. Support collection advantages outside of (or after) bankruptcy competitively overwhelm financial institutions. For example the following post-bankruptcy collection advantages are available to support creditors, but not to credit card or other financial institutions:

a. Priority wage withholding to collect support.
b. Interception of state and federal tax refunds to pay child support arrears.
c. Garnishment or interception of Workers' Compensation or Unemployment Insurance Benefits.
d. Free or low cost collection services provided by the government.
e. Use of interstate processes to collect support arrearage, including interstate earnings withholding orders and interstate real estate liens.
f. Revocation or suspension of driver's, professional and recreational licenses of support delinquents.
g. Criminal prosecution and contempt procedures for failing to pay support debts.
h. Federal prosecution for nonpayment of support and federal collection of support debts.
i. Denial of passports to support debtors.
j. Automatic treatment of support debts as judgments which are collectible under state judgment laws, including garnishment, execution, and real and personal property liens.
k. Collection of support debts from exempt assets.

while this list is not exhaustive, it is certainly illustrative of the vastly superior advantages of support creditors over commercial creditors. For these reasons I do not consider S. 220 as a mechanism for "elevating" credit card debts to the position of support debts after bankruptcy in any sense of the word. Moreover, absent passage of the changes contained in S. 220, the government is currently precluded from using many of these techniques while a bankruptcy case is pending—a fact that currently makes bankruptcy a haven for recalcitrant spouses and parents.

Question 3. Explain what is wrong with the position taken by 116 law professors who wrote the Senate last year, that the most important issue for women and children raised by this bill is that it will make is much more difficult for them to reach an ex-husband's income after that ex-husband goes through bankruptcy?

The short answer is that nothing about 5.220 makes it more difficult to reach the husband's income post-bankruptcy in that nothing about the bill affects post-bankruptcy activities in that regard. Rather, as described above in question 2, support creditors continue to enjoy substantial advantages in being able to collect from the former spouse's post-discharge income. Perhaps, a more salient question is how many of these law professors have ever actually enforced a support obligation? I, and thousands of my colleagues, do it every day and take pride in obtaining that support, under difficult circumstances, for the children who are entitled to it. We know where the problems lie and would hardly be supporting legislation which would make the collection of that support more difficult. The support provisions of this bill are supported by:

a. The National Child Support Enforcement Association
b. The National District Attorneys Association
c. The National Association of Attorneys General
d. The Western Interstate Child Support Enforcement Council

With respect to the effect of this bill on support collection, if we are just counting numbers of supporters and adversaries, one need look no further than the National Child Support Enforcement Association which urged the President to sign it last year. This organization represents over 60,000 child support professionals in this country with the daily hands-on experience to know where the problems lie and what changes they would like to see made to address those problems. While no bill is perfect, we believe the changes made to the domestic support provisions of the Bankruptcy Code by this bill are an overwhelming improvement over the current law.

If you have any other questions please do not hesitate to contact me.

Yours very truly,

PHILIP L. STRAUSS
Principal Attorney
Department of Child Support Services

Responses of Todd I. Zywicki to Questions from Senator Feingold

Question 1: Concerning the proposed means test in S. 220, you stated that "we've identified about 7 to 10 percent of filers who would be affected by the means test. . . .We're talking about recovering $3 billion, roughly, that would otherwise be discharged [in Chapter 7]."

(A) What is the source of your statement?

Answer: My statement is based on a composite assessment of the various studies that have been done to try to estimate the impact of means-testing generally. It is difficult to establish a precise figure, as the various studies were conducted according to different versions of means-testing that have been proposed over the past several years. Nonetheless, the February 1998 Ernst & Young study using 1992–93 data concluded that about 15% of filers would be affected by means-testing. The March 1998 Ernst & Young study again concluded that about 15% of filers would be affected. A study by the Credit Research Center in 1997 concluded that 5% of the filers in its study could have repaid 100% of their debts over five years and that approximately 25% of filers could have repaid 30% or more of their debts. A study by Marianne Culhanne and Michaela White that was sponsored by the American Bankruptcy Institute concluded that approximately 7% of the debtors in their sample would have been affected by means-testing. It has been reported that this last study found that only 3% of filers would be affected, but that conclusion was based on a patent misunderstanding of the IRS guidelines that will apply to means-testing. In particular, it is based on the erroneous belief that the IRS guidelines would actually allow a debtor to buy a new car while in bankruptcy, an interpretation of the IRS guidelines that is simply incorrect. Once this error in the interpretation of the automobile exception is corrected, the final figure, as noted rises to approximately 7% of the sample. Also, the ABI study was of substantially poorer quality than the other studies, as that study was smaller in size, drawn from fewer districts, and based on older data than the other studies. As a result, the results of the ABI study are not as probative as the other studies. Nonetheless, its conclusions are consistent with the findings of the other studies once its erroneous assumptions are corrected. I chose the figure of "about 7 to 10%" as a conservative assessment to convey that the estimates were tentative but that most of them fell within this range or above.

(B) What did you do to "identify" the 7 to 10 percent of Chapter 7 cases that would be "affected by the means test"?

Answer As noted, I relied upon a composite of studies conducted by researchers and did not conduct my own study.

(C) Particularly, with respect to the $3 billion that you say would be recovered under the proposed means test, where can we find the statistical evidence for that claim?

Answer: A 1998 study by the WEFA Group concluded that means-testing would recover $3.6 billion to $7.4 billion that is currently discharged in bankruptcy. The March 1998 Ernst & Young study concluded that the WEFA, study likely underestimates the amount of debt discharged in Chapter 7 and that is also underestimates the amount that would be recovered by means-testing. Those studies were both based on assuming that those. making 75% of the national median income would be eligible for means-testing, rather than the current standard of 100% of state median income. This adjustment might exclude a handful of filers with some modest repayment capacity, but would not likely have a large effect on the overall amounts recoverable. Given this, I chose the figure of $3 billion as a conservative estimate of what these studies suggest could be recovered in bankruptcy according to the current version of the means-test.

Responses of Dean Sheaffer to Questions submitted by Senator Feingold

Dear Chairman Hatch:

I am in receipt of your February 20, 2001 correspondence forwarding written questions submitted by Senator Feingold regarding my recent testimony in support of S. 220. My responses follow.

Question 1: Your testimony on behalf of the National Retail federation focuses exclusively on abuse of the bankruptcy system by debtors and does not make any mention of the fact that quite a few retailers have admitted to committing bankruptcy fraud on a widespread basis.

Question 1 A: Has your company engaged in any postbankruptcy collection acti vity without filing reaffirmation agreements?

Answer: Boscov's maintains policies that require compliance with local, state and federal statutes and regulations, including federal bankruptcy taw.

Question 1B: Do you think that the current laws suporvising reaffirmation agreements have been adequate?

Answer: Yes. The sufficiency of the current supervision is evidenced by the fact that retailers accused of reaffirmation violations have been identified and fined up to approximately one-third of a Billion dollars.

Question 1C: Do you have a problem with requiring court review of all reaffirmation agreements, rather than only those that are made by debtors who don't have counsel?

Answer: With over one million bankruptcy filings each year, we view this is an unnecessary burden to the court system. Debtors' counsel have a clear obligation to protect their chonts' interests.

Question 2: In your testimony you conclude that our current bankruptcy laws cost the average American family hundreds of dollars each year.

Question 2A: How do you arrive at that figure?

Answer: Total annual bankruptcy losses are more than $40 Billion. There are approximately 100 million U.S. households; thereforc, the average annual loss per household is approximately $400.

Question 2B: Assuming that it is simply based on the amount of debt discharged in bankruptcy, do you agree that if the laws are changed and fewer Americans file for bankruptcy and less debt is dischargoablc, the cost the bankruptcy laws to the American consumer may not necessarily drop? In other words, do you recognize that them are other costs and effects of the laws that ought to be considered by policy makers?

Answer: We recognize that there are other factors that may effect the "net" benefit of bankruptcy reform to American consumers. We believe that these have been—fully considered by Congress over the course of the last five years. S. 220 carefully balances these factors.

Question 3: You said in your testimony that "over $40 billion was written off in banlauptcy losses last year, which amounts to the discharge of at least $110 million every single day." Please provide us with the documentation or source for the statistics in your statement.

Answer: It has been widely reported that annual bankruptcy losses are between $40 Billion and $45 Billion. $42.5 Billion divided by 365 days is greater than $110 Million.

Question 4: Your testimony focuses on the importance of the means test. As you know, S. 220 which you endorse in your testimony contains many other provisions.

Question 4A: Are the bill's provisions that expand the nondischargeability of credit card debt important to your support of the bill?

Answer: Retailers see many cases where unnecessary purchases of luxury goods are made in preparation for bankruptcy. The marginal changes in the existing nondischargeability provisions will prevent the costs of such abuse from being "transferred" to American consumers as a whole.

Question 4B: Do you think that the bill's provision that deny the bankruptcy stay to tenants who are facing eviction and would actually be able to pay their rent during the bankruptcy are necessary to address the retailers' concem with the bankruptcy system?

Answer: Retailers have not advocated in favor or against this provision. We understand that there are strongly felt, and well founded, views on both sides. The current provision is part of a heavily negotiated and carefully balanced bill which attempts to address the interests of debtors, creditors, and the public at large. The NRF supports swift passage of S. 220 without additional amendment.

Question 4C: To get your support, does the bankruptcy reform bill have to contain the provisions of S. 220 that inflate the value of secured debt by denying cramdown or stripdown of car loans taken out within 5 years of a bankruptcy filing?

Answer: This provision is part of a heavily negotiated and carefully balanced bill which attempts to weigh not only the interests of both debtors and creditors, but the competing interests among creditors as well. The NRF supports swift passage of S. 220 without additional amendment.

Question 4D: Could you support a bankruptcy bill that includes a means test and reaffirmation provisions, even if it didn't contain all of these provisions mentioned above, about which consumer advocates and law professors have been so concerned?

Answer: The provisions mentioned above address genuine misuses of the current law in a reasonable and balanced fashion. While some individuals believe that the final product does not go as far as they would like, others believe it goes too far. Retailers believe that whatever the bill's alleged shortcomings, it is a significant improvement over the present abuse-prone system.

Responses of Brady C. Williamson to Written Questions

Question 1: How would the means test in the bill affect families with extraordinary medical expenses?

Answer: The means test in the bill does not provide any flexibility in its application to take into account extraordinary medical expenses. The bill, in section 102, establishes a means test that applies regardless of the reason for a family's financial difficulty. It applies with equal force, in this regard, to the honest but unfortunate debtor and to the debtor determined to defraud creditors. The bill should be amended to provide an exemption from the means test for families forced into bankruptcy by extraordinary medical expenses.

Question 2: What is your view of the reaffirmation provisions in S. 220? Are there improvements to be made to these provisions that will make them more effective in combating creditor abuse?

Answer: While the bill makes slight improvements in the reaffirmation process, it does not address the more fundamental, problems, problems that became painfully evident with the criminal and civil penalties imposed on several of the country's leading retailers for reaffirmation abuse. Some creditors use the "carrot" of additional credit to turn dischargeable debt into nondischargeable debt whether or not the debtor can afford to continue to make payments. Others use the "stick" by threatening to ask the court to declare the debt nondisehargeable, litigation the debtor cannot afford to defend.

The reaffirmation process does not involve parties with equal bargaining power or equal sophistication. The 1975 bankruptcy commission recognized this when it recommended the abolition of reaffirmation agreements. The 1997 commission essentially reiterated this recommendation.

Some of the provisions in the bill actually increase the need .for stronger reaffirmation protection. With more debt nondischargeable under the bill than under current law, the post-bankruptcy burdens of a debtor will be greater. That decreases the debtor's ability to make post-bankruptcy payments on debt that has been. reaffirmed, jeopardizing the prospects for a successful Chapter 13 proceeding. New provisions in the bill provide additional opportunities For aggressive creditors to threaten actions against debtors, which they can "settle" by taking reaffirmation agreements. The bill's reaffirmation provisions, as written, do not curb abuses. Rather, they only standardize reporting and procedures.

Yes, improvements can and should be made in the bill. The bankruptcy courts should have to evaluate reaffirmation agreements, as they did from the enactment of the bankruptcy code in 1978 through 1984, asking whether the debtor has the capacity to meet his/her obligations and still give preferential treatment to one creditor in a reaffirmation agreement. The law should require the court particularly to determine if the debtor can make reaffirmation payments and still satisfy his or her obligations to a current or former spouse and their children. In addition, other creditors who are entitled to depend on the debtor's income for payment in a Chapter 13 or after a Chapter 7 bankruptcy also should be protected.

At the very least, the bill should be amended to require court approval for reaffirmation agreements with any debtor who has spousal or child support or other family obligations. While this would not restore the reaffirmation provisions of the code to their 1978 status, it would protect those most vulnerable to an improvident reaffirmation agreement and their other creditors.

Responses of the Administrative Office of the Courts to Questions submitted by Senator Leahy

Question 1: I recall last year the Congressional Budget Office estimated that it would cost $218 million over the 2000–2004 period to implement the new bankruptcy—provisions of S. 625. Have you or the Administrative Office of the Courts made any estimates about how many millions of taxpayer dollars would be required to meet the mandates of this year's bill, S. 220?

Answer: The Congressional Budget Office (CBO) estimate of $218 million to implement the provisions of S. 625 is a government-wide cost estimate. We defer to CBO with regard to the estimate of government-wide costs to meet the mandates of S. 220. Extrapolating from the analysis of S. 625 by the Congressional Budget Office, the Administrative Office has estimated that implementation of S. 220 would cost the judiciary approximately $104 during the five-year period following enactment of the bill, and in some instances, following a delayed effective date. This figure is obtained as follows:

Data collection		$30 million
Maintaining income tax returns		9 million [1]
New judgeships—.		
discretionary costs	$51 million.	
(administrative costs)		
mandatory costs	$14 million.	
(salaries and expenses)		
		65 million [2]
Increased cost		$104 million

Although your question does not specifically raise the issue of lost revenue, the bill as introduced would revise filing fees in chapter 7 and chapter 13 cases and re-

[1] The provision in S. 625 regarding the maintenance of tax returns would have required all chapter 7 and chapter 13 debtors to file three-years tax returns with the bankruptcy court. CBO

allocate a portion of the revenues derived from those fees from the judiciary to the United States Trustee program. We estimate this loss in revenue to exceed $25 million over the next five years. This is as "real" a cost as a required increase in outlays, When this figure is added to the direct cost imposed by the bill, our total cost approaches $130 million, all of which will require an increase of judiciary appropriations.

Question 2: Do you have any other legislative proposals to improve provisions in the current bankruptcy reform legislation besides the direct appeal provision?

The bill as introduced would create 23 new temporary judgeships and extend the terms of four existing temporary judgeships. The Judicial Conference recommends creation of the 23 judgeships currently in the bill as well as two others—one in the district of Maryland and one in the district of South Carolina. It further recommends that 13 of these judgeships be created on a permanent basis and the other 12 on a temporary basis; that the existing temporary judgeships in the district of Delaware, district of Puerto Rico and northern district of Alabama be converted to permanent positions; and, that the temporary judgeship in the eastern district of Tennessee be extended for a period of five years.

Reason: Creating temporary judgeships where permanent judgeships are clearly needed detracts from the most efficient administration of the bankruptcy code. Extending temporary judgeships for very short periods of time is also bad policy. The fact that South Carolina lost a judgeship in January 2000 although that judgeship is needed points up this problem. Congress has not created a new bankruptcy judgeship since 1992. Future Congresses should not be "forced" to frequently pass "temporary judgeship extension" bills, particularly when the failure to act is not in the public interest.

We recommend deletion of the provision that would revise filing fees (which were revised only 14 months ago) and re-allocate revenues derived from those fees from the judiciary to the United States Trustee program. This provision would have the effect of depriving the judiciary of approximately $25 million over the next five years.

Reason: The judiciary expends significant funds administering the bankruptcy code. In recognition of this fact, in 1999, Congress, acting on the decision of the Senate and House Appropriations Committees, increased certain bankruptcy filing fees and allocated the revenues derived from those fees with due regard to the costs of both the judiciary and the United States Trustee program. S. 220 re-opens that decision by again revising fees, reducing judiciary revenues, and significantly increasing income to the United States Trustee program. The decision to reduce judiciary revenues disregards the rationale underlying current law and ignores the $104 million five-year cost increase that the enactment of S. 220 will levy upon the judiciary.

We recommend re-assigning the responsibility for collection of financial data on debtors from the judiciary to the United States Trustee program as an adjunct to its responsibility to conduct audits under the bill.

Reason: Having financial data collected by United States Trustees would have two significant benefits. First, it would yield audited, and thus accurate, data. By contrast, having bankruptcy clerks collect the data from schedules and statements filed by debtors at the outset of cases will result in unreliable data. Data filed by debtors, in many instances without the assistance of a lawyer, frequently inaccurately values assets and liabilities; further, some debt simply cannot be valued definitively at the outset of a case because it is unliquidated, contingent or disputed. Second, since data would be collected by Trustees as part of its audit system, it would be collected at a fraction of the cost of C5tab11tshlng a new system for this purpose in each clerk's office.

We recommend re-assigning the responsibility to maintain income tax returns from the bankruptcy clerks to the United States Trustees.

Reason: In order for the courts to meet this new responsibility, it will be necessary to establish a new filing system in each clerk's office, separate and apart from public case files, in order to safeguard the security of the records and control access to

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estimated this cost to the judiciary to be approximately $34 million over five years. The analogous provision of S. 220 requires a debtor to file tax returns only upon request of a creditor. CBO estimates that.this provision, when compared to its predecessor, could result in savings of as much as $25 million, depending upon the number of cases in which creditors seek access to the returns. Thus, assuming a best case scenario, the pending bill would impose a cost of approximately $9 million upon the judiciary.

[2] Analyzing the judgeship provision of S. 625, CBO determined that the creation of 18 new bankruptcy judgeships would cost $40 million in discretionary spending and $11 million in mandatory spending over the next five years. Extrapolating these figures to determine the cost of 23 new judgeships, as would be created by S. 220, yields $51 million in discretionary spending and $14 million in mandatory spending, for a total of $65 million.

them as required by the bill. Since the Trustees' files, unlike court files, are not publicly available, the Trustees would be able to meet this responsibility without the costs and administrative burdens associated with establishing and maintaining new filing systems.

We recommend extending the date for initiating collection and reporting of case event statistics.

Reason: Docket sheet information in bankruptcy cases is reported to the Administrative Office through the electronic case management systems of the courts. The current systems are nearing the end of their useful lives and are an a schedule to be replaced. These systems cannot collect additional information of the sort required by this bill without costly upgrades that would divert resources from the new replacement system that is in the process of being deployed in the bankruptcy courts. Since the new system will not be deployed in every court for three and a half years, this provision should be revised to take effect 48 months after enactment of the legislation.

Finally, we recommend deletion of provisions regarding revision of bankruptcy rules.

Reason: Two provisions of the bill, sections 102 and 319, inappropriately impact Bankruptcy Rule 9011 and, if enacted, would cause confusion and needless satellite litigation. Six other provisions require the Supreme Court or the Judicial Conference or the Advisory Committee on Bankruptcy Rules to promulgate a rule or official form. Directing the Judicial Conference or one of its committees to amend a particular rule or form bypasses the Rules Enabling Act process and needlessly undercuts the proper role of the Judicial Conference and its committees, the bench and bar, the public, and the Supreme Court in that process. Furthermore, these provisions are unnecessary because the Advisory Committee on Bankruptcy Rules automatically reviews any legislation amending the bankruptcy code to identify and prescribe necessary amendments to rules and forms.

Responses of Robert D. Manning to Questions submitted by Senator Leahy

As per your request, the following is my response to your questions regarding recent trends in consumer bankruptcy. This information is a follow-up to my testimony before the Serrate Judiciary Committee on February 8, 2001. I respectfully request that these questions and answers be added as an addendum to my testimony.

Question 1, Part A: "Over the last 15 years, how have the marketing and lending practices of the credit card industry changed in regard to college students?"

Question Part B: "Have these policies contributed to greater student credit card debt?"

Answer: Due to the onset of banking deregulation (beginning in 1980, e.g. elimination of Regulation Q) and massive loan losses of the major money center banks due to questionable underwriting policies with 'third World countries as well as U.S. commercial/residential loan losses during the 1989–91 recession, the banking industry found that credit cards were one of their most profitable lending activities after doubledigit inflation subsided following the 1981–82 recession. As banks began expanding the marketing focus of revolving credit cards after the recession, such as soliciting lower income, blue-collar households that were coping with un- and underemployment during the restructuring of manufacturing industries, they realized that the most neglected and potentially profitable market niche was middle-class college students.

Until the late 1980s, the standard industry practice required that students had to have their parents or guardians co-sign the credit cardholder agreement, unless the student demonstrated sufficient income to pay for the modest line of credit. At the same time, the first exclusive marketing agreements were being negotiated for modest sums with college administrators, beginning with MBNA and its agreement with Georgetown University in the early 198Os, but this was solely for employed alumni.

As credit card and retail companies sought to expand from college alumni into the college student market, they began soliciting to college seniors who were 21 years old and soon to enter the job market. That is, the lending risk was relatively low with the assumption that college seniors had one foot in school and the other foot looking for a job. Typically, these student "kiddie" cards offered credit in the $200–$500 range, most were around $300. Hence, the industry was concerned about lending money to unemployed students based on the *uncertainty of—the student card-*

holders' ability to repay. By ensuring repayment through parental co-signature, the industry faced the trade-off of low risk in its underwriting standards and limited profits since students' consumption would be monitored by their parents and thus their behavior would still be influenced by "family values" and parental authority.

By the late 1980s and especially during the 1989–91 recession, the credit card industry discontinued its requirement of parental co-signature anal aggressively marketed credit cards on campus. In 1990, Citibank was nearly insolvent (low Tier 1 capital reserve levels) due to its unperforming.Third World and commercial/residential lending loans and end of cheap capital due to the phase-out of Reg Q. However, credit cards in general and college students in particular were yielding sharply rising profits. As a result, students were directly solicited through the mail, campus bulletin boards, inserts in book store bags, and the growing presence of direct marketers such as application booths or on-campus fundraisers such as fraternity and sorority programs. Significantly, my research shows that few students graduated in the early 1990s with high credit card debts; rare was a student with $5,000 in debt and most in the $500 to $2,000 range. These students were far more likely to accumulate their credit card debt after graduation while they encountered difficulty finding employment in a tight job market. So, the seeds of mounting credit card debt were planted during college but harvested after graduation.

During the early 1990s, as *credit card companies raised credit card lines of credit—due to rising debt levels—of students rather than hi student incomes*, credit card companies sought to reduce their risk by a policy of having debt collectors contact parents and demand payment and even pursue legal suits for debt collection against parents of college students—even if they were not co-signatories of the cardholder agreement. The success of this policy emboldened credit card companies to continue to increase the lines of credit to students as parents and family members found themselves unexpectedly paying off student credit card debts. Also, as the cost of college education rose with the sharp decline in public financial support, student loans routinely replaced federal grants axed family loans in the 1990s.

The increasingly common strategy of financing one's college education with borrowed money contributed to the credit card industry's realization that its risk was further reduced by students paying their credit card debts with student loans. This trend also minimized the perception of the growing problem of student credit card debt since reports focused on current credit card balances rather than total, accumulated credit card debt that was amassed through private bank lows, family loans, and shifting credit card debt into student loans. As a result, students that charged up to their limits on their credit cards were actually rewarded with higher lines of credit or even additional credit cards. This policy continued even after the credit card industry lost its law suits in the early 1990s in an effort to force parents to repay their children's credit card debts even though they were not co-signers of the credit card agreement. The credit card industry's response, which continues today, is to have debt collectors pressure the parents of college students to repay the credit card debts of their children. The punitive threat is that the failure to pay delinquent credit card debts will lead to serious consequences for their children in the future: bad credit reports/scores, much higher interest rates and insurance premiums, loan denials such as auto and mortgages, and even job rejection.

By the mid-1990s, credit card companies began to double their marketing budgets, including more aggressive campaigns on college campuses. This was because the risk of defaults diminished for banks (due to student loans, family loans, greater available of part—time jobs during economic expansion) while the demand for credit cards on campus soared due to escalating consumption pressures on campus and the rising cost of college matriculation which led to greater reliance on borrowed money to finance college expenses. With the optimism of the economic expansion of the 1990s spurring the consumer-driven economy, the highly profitable student credit card portfolios led banks to an intensifying competition over prize college accounts. Indeed, banks began to realize that credit cards provided entire to middle class households during their most formative years and thus offered future additional, lending/proft opportunities: auto, home mortgage, investment, insurance, and even college loans. With the end of the recession, the consolidation of the credit card. industry began to accelerate which. led to more lucrative exclusive marketing agreements with universities and their alumni associations (especially the largest 250 universities). In, addition, this expanded marketing campaign resulted in a larger on-campus presence through sponsored events (spring fairs, athletic events, spring break activities, campus newspaper advertisements) and subcontracted solicitors who boldly established tables and booths in student centers, outside cafeterias, in dormitory "commons" areas, and along classroom walkways. Not incidentally, the increasing use of subcontracted marketing companies led to increased pressure tactics and illegal policies such as submitting applications with forged signatures and alter-ing the age of applicants (e.g. high school students visiting college campuses or underage freshmen). Daily fees paid to colleges in order to "rent" on-campus booths or tables typically range from $50 to $250. However, an increasingly common practice is to solicit without authorization or simply to "crash" a campus. Robert Bugai, President of College Marketing Intelligence and an investigative journalist, has documented hundreds of cases of marketing abuses on college campuses in the 1990s.

The more aggressive marketing of credit cards on campus, together with the implicit assent of university administrators who saw greater access to credit as a revenue generator by enabling students to pay for the higher cost of educational expenses plus million dollar marketing agreements, led to marketing not just to alumni and upper classmen but then to freshmen and sophomores. Not only had solicitations become commonplace in book bags but they had become an accepted feature of freshman orientation. More importantly, the lines of credit offered to student soared. From an initial $300 to $500 lime of credit, students, found that they could request or were automatically offered lines of credit of from $2500 to $5000 within a year, Furthermore, students were now offered multiple credit cards; if they exhausted their credit on one card then they could receive two or three others. As the underwriting standards eroded, students became a distinct market niche for banks. In only a decade, the required co-signature with parents was replaced with only some proof of enrollment in college.

By the mid-1990s, some students were amassing $5,000 to $15,000 in credit card debt and parents were finding themselves in the dilemma of "loaning" their children the money to pay off their debts or teaching them a lesson in financial responsibility. With the booming economy, students could easily find part-time jobs and/or their parents were more likely to have savings or access to lower interest loans to payoff these debts. Increasingly, students in public schools used larger portions of their student loans to pay down their credit cards while private school students began resorting to private bank loans or college credit union loans; at Georgetown University, I was informed that the most common use of the $10,000 loan available to students at the university credit union is to pay for their credit cards. Increasingly, students that "mixed-out" their credit cards were rewarded with higher hues of credit or other credit card applications. By the end of the decade, college campuses have become filled with anxiety ridden students whose request for holiday gifts were often "please pay may credit card debt." More importantly, credit card debts of the most indebted, mixed out students jumped from $10,000 $15,000 range to $20,000–$25,000. In a few cases, financial aid offers have communicated to me that they have had students from disadvantaged backgrounds report that they have accumulated over $30,000 in credit card debt. More recently, attention has focussed on the medical, educational, employment, and financial impacts (even suicides) associated with escalating student credit card debt.

Today, the most striking feature of credit card marketing is how young students are when then receive their first credit card. In 2000, an industry sponsored survey reported that 25% of college seniors reported receiving credit cards before starting college compared to 55% of college freshmen. In some cases, students have simply applied for bank credit cards while in high school while others have been solicited due to their use of retail credit cards or are secondary account members of their parents' credit cards. In fact, the new VISA BUXX credit card program, which requires parental co-signature, is designed for teenagers. Most importantly, as the marketing of credit cards has shifted from employed alumni and then college seniors to college freshmen arid now high school students, there has not been a corresponding increase in financial education as credit increasingly is being allocated to consumers before they begin full-time employment. Unlike driving a car, young people are being given the "keys" to the consumer lifestyle but not required to learn the necessary defensive "driving" skills.

Lastly, the interest rates and penalty fees are among the highest levels in the college student market. More importantly, credit card companies recognize that college students are mobile and have crisis periods which commonly lead to cash advances and penalty fees that quickly lead to sharp increases in credit card finance charges: from 22.8% to 27.9% APR. For instance, a student that forgets to pay his/her credit card bill during final exam week may then wait until the forwarded mail arrives at parents' home or summer job. Often, the student is now two (2) payments late which invokes the "escalator" clause and thus requires the student to pay the highest finance charge rate.

In sum, the last decade has seen a dramatic rise in the extension of credit to increasingly younger students without any accompanying financial educational programs. As the cost of higher education has risen and the cost of the student lifestyle has escalated, it is not surprising that the highest credit card debt levels of students have jumped sharply over the last 10–12 years: from less than $5,000 to over

$25,000. And, the proportion of students with credit cards is now between 75 and 80 percent.

Question Part C: "Are these policies different for young adults of the same age that are not college students?"

Answer: The different status and underwriting standards of college students is revealed by the policies of the credit card industry as they apply to .non-students in the 18–23 year-old age range. For this age group, proof of employment and total income are required as well as a consumer credit investigation. Young adults that report typical student incomes of $3,000 to $8,000 per year are routinely rejected for bank credit cards or offered "subprime" credit cards with low credit limits and high mandatory fees. For instance, a typical subprime credit card offers from $300 to $900 in credit with the highest interest rates (19.9%–36% APR) as well as requires membership fees ($20–$50), processing fees ($10–$25), and educational materials ($75–$199). In addition, they may be offered more costly "secured" cards that require a bank deposit that determines the amount of credit offered. For example, a $100 deposit will result in a credit line of from $100 to $250 and often a high membership fee. Even more instructive is the experience of students after graduation that do not get credit cards in college or accept only low credit limits. Commonly, recent graduates with relatively low-wage, entry-level jobs (and typically high student debt levels) are offered low credit limits and even rejected for new credit cards. In sum, there is clearly a "double standard" in offering unsecured consumer loans via credit cards to students versus non-students of the same age. Ironically, young adults with relatively low-wage, full-time jobs ate more likely to be rejected for bank credit cards and/or offered low credit limits than their peers who are unemployed and may have never had a fell-time job.

Question 2, Part A: "Are young adults the fastest growing bankruptcy filers today?"

Answer: Yes, young adults 25 years-old and younger have experienced a dramatic rise in their bankruptcy rates. In 1995, with the number of bankruptcies at a near record of almost 900,000, less than 1 percent or under 9,000 bankruptcy filers were 25 years old oar younger. When U.S. personal bankruptcies peaked at 1.4 million in 1998, this included about 68,000 young adults or approximately 4.9 percent of the total. In 2000, it appears that the proportion of bankruptcy filers 25 years old or younger has jumped to over 10 percent of the total—over 100,000 people. According to bankruptcy expert Professor Elizabeth Warren (Harvard Law School), who is the director of a national survey of bankruptcy filers and co-author of *The Fragile Middle Class* (Yale, 2000), bankruptcies among young adults are continuing to increase today.

Question Part B: "What are the primary factors responsible for this new trend of the late 1990s?"

Answer: As the cost of a college education has soared over tine last two decades, the average debt levels of college graduates has similarly increased; federal grants have been increasingly replaced with federal loans. At the end of the 1990s, student loans of public school graduates averaged over $13,000 and student loans of private school graduates averaged over $16,000. With shorter deferment periods (typically 6 months), higher finance: rates plus increasing amounts of unsubsidized loans, and the end of income tax averaging as well as deductibility of interest on student loans (interest deductibility was re-instituted in 1998-to a maximum of $2,000), recent graduates with modest incomes from their entry level jobs found themselves squeezed by their substantial education and credit card debts.

Furthermore, the consumption-oriented lifestyle that is being promoted on college campuses bias been viewed by students as an entitlement that is expected to be continued after graduating anal obtaining a full-time job. Indeed, this is a generation that has not experienced a recession and has been encouraged to accept debt as a middle-class entitlement rather than 'saving for a rainy day.' Unfortunately, this short-sighted attitude has been reinforced in college by encouraging the use of 'plastic money,' the CitibankSony Visa—'the currency of fun,' and the self-deprecating reference to credit cards as 'yuppie food stamps.' In addition, the recent employment volatility of hi-tech sector companies has pushed more young adults into debt-counseling/debt refinance programs. Since they are the least likely to have accumulated equity through homeownership, unlike their parents, a larger proportion of heavily indebted young adults are funding few financial "life lines" and thus no other recourse but to file for bankruptcy.

Question Part C: "How will the proposed bankruptcy reform legislation affect them?"

Answer: In many ways, as the fastest growing group of bankruptcy filers, young adults are the most disadvantaged by the proposed bankruptcy legislation. This could have serious long-term consequences to the nation since these age cohorts currently have the lowest (negative) savings rate.

First, for many of these bankruptcy filers, their college debts are the first or second largest debts. Since student loans normally can not be discharged, many young filers will find relatively little relief from the bankruptcy process-especially with the difficulty in obtaining future credit when they are so early in their consumer lifecycle. This situation is especially difficult for those with student loans that did not graduate from. college or whose vocational training did not offer marketable job skills.

Second, the much higher finance rates of consumer credit card debts encourages students to pay for them with low-interest college education loans. For many young adults that file for bankruptcy, this decision means that they are required to pay for past credit card bills since these debts have been shifted into student loans. As the credit card industry demands that a larger proportion of credit card debt be repaid, they fail to acknowledge that a substantial portion is not dischargeable and must be repaid after it has been "revoted" into student loan debt. Since this was not an option for undergraduate students a decade ago, the deleterious impact is primarily assumed by young adults under 30 and especially under 25 years old.

Third, this age group is least likely to own their residences and thus have the ability to protect personal assets through home ownership. Proposed changes in consumer bankruptcy law that help households protect some of their accumulated assets via home ownership do not affect most young adults filing for bankruptcy.

Fourth, the most common form of start-up capital/financing for small businesses especially young entrepreneurs-is bank credit cards. Since these young adults are the least likely to have accumulated much equity through home ownership and thus have the option of "home equity" loans, business failure could push them into personal bankruptcy since they have few opportunities to secure small business loans.

Fifth, with a slowdown in the economy and the accompanying rise in employment disruptions, the inability to discharge any student loan debts may lead to a greater likelihood of multiple bankruptcies by the youngest age cohorts of bankruptcy filers whose only option will be to increase the length of time of their loan repayment period.

Question 3. Part A.: "How do the lending and underwriting policies of small banks and regional retailers compare with the major credit card companies."

Answer: One of the most striking trends of banking deregulation is the increase in providing consumer loans in the form of "evolving" or unsecured credit cards rather than the traditional "installment" loan that dictates a fixed term of repayment at a specified monthly payment and interest rate. At the conclusion of the contract, the consumer has accumulated equity in the purchased item (auto, furniture, appliance) and the merchant or bank rewarded responsible consumers with more credit in the future.

Small banks and regional retailers require a more extensive application process for consumer loans and tend to be more cautious in their underwriting criteria. Also, they have the option of repossessing the defaulted consumer goods (computers, stereos, autos) whereas unsecured credit cards are more likely to be used for purchases on consumer services that can not be repossessed. Unfortunately, credit cards have turned upside down the logic of financial lending: the most profitable loans are those that are not repaid. As a result, the most desired clients of the credit card companies are consumers that dutifully remit payments on their loans (especially late!) bust do not pay in full. In fact, in some cases, credit card companies may cancel the accounts of clients that payoff all of their charges each month arid disdainfully refer to them as "dead beats." The result is that small banks and retailers tend to have more stringent lending criteria, encourage installment loans, and offer consumers lower lines of credit.

Question 3. Part B: "Do consumer defaults on loan contracts affect retailers the salve as large credit card companies?"

Answer: One of the major problems with the dramatic increase in the amount of consumer lending through bank credit cards is that it has shifted more financial risk to retailers and smaller banks. For example, a regional furniture store company that carefully limits the size of its consumer installment loans has no control over the additional amount of debt that its clients may obtain through bank or other retail credit cards. 'this is important because a default on a consumer loan means that the furniture company and/or its bank partner lose the amount of the consumer's financial delinquency. For the furniture company, this means that it has to absorb some portion of the defaulted consumer loan or it may lose its banking partner and thus financing source for future sales. For the consumer, the loss of modest cost financing may mean higher costs by obtaining a loan through a dance company.

The link between. prudent installment credit by small banks and retailers and the weak underwriting criteria of major credit card companies (top ten credit card companies control ¾ of the market) merits greater attention. That is, "good" installment loans may end up in bankruptcy court because of future "bad" credit card debts. And, because of this relatively new shift in the relative allocation of consumer credit through "installment" loans versus unsecured "revolving" credit cards, both types of loans are treated equally whereas the risk to retailers has increased substantially. This is because major credit card companies sell much of their credit card debt in secondary markets (U. S., Europe, and Asia) as "securitized" financial instruments. Higher default rates on credit cards often simply means that the "bundle" of credit card debt sells at a lower premium rather than producing a direct loss such as a default on a loan for the purchase of a stereo system.

In sum, requiring bankruptcy petitioners to repay a portion of unsecured credit card debt could encourage banks to increase high interest consumer loans to financially insecure or distressed households that have the greatest likelihood of not being able to repay the loans. This, of course, would create a greater financial burden on low-income households and especially single, female-headed households with children. This impact has been previously discussed and documented. What has been generally neglected is how this proposed change in the bankruptcy law could seriously hurt retailers in general and smaller companies in particular. That is, these most recent trends suggest that a more effective change in consumer bankruptcy law should require more prudent lending policies by major credit card companies in the marketing of relatively large amounts of credit to low and middle-income households.

Please contact me if you require any additional information.

Responses of Todd Zywicki to Questions submitted by Senator Leahy

Question 1: You testified that the current bankruptcy system is "threatening to spiral out of control" and "suffers from a crisis of both real and perceived abuse." But over the last two years, Chapter 7 filings have dropped 15 percent and personal bankruptcy filings overall have declined by 12 percent across the nation. How can the current system be out of control and in crisis when personal bankruptcy filings have declined so dramatically in the last two years?

Answer: After a brief respite in bankruptcy filing rates, bankruptcy filings have begun to rise again this year. I am not aware of any bankruptcy analyst who believed at the time that the two-year decline in bankruptcies presaged a permanent, rather than a temporary drop. Moreover, despite these slight reversals, the fact remains that despite a decade of unprecedented economic prosperity, consumer bankruptcies are almost twice as high as 1990, and are five times greater than in 1980. Most analysts expect at least a 15% increase in bankruptcy filings this year. Moreover, recent history suggests that bankruptcies tend to rise during a recession. Thus, if it is true that an economic slowdown portends, then this augurs a continuing rising tide of bankruptcy filings and threatens to cause the bankruptcy system to "spiral out of control."

Question 2.: You testified that S. 220 should be enacted into law to stop the "bankruptcy tax" caused by bankruptcy abuses, which "is reflected in shorter grace periods for paying bills, and higher penalty fees and late-charges for those who miss payments." What guarantee is in S. 220 that any savings to the credit industry from the passage of the bill will be passed down to consumers in longer grace periods for paying bills, and lower penalty fees and late charges for those who miss payments?

Answer: As I testified, bankruptcy losses are a cost of doing business for firms that extend credit. As such, they are no different from other business expenses, whether rent, employee salaries, taxes, electricity bills, theft, or gas prices. The government provides a system of courts to enforce contracts in the belief that making valid contracts enforceable decreases the costs of doing business, which in turn favors all buyers and sellers, including consumers. Does anyone believe that eliminating the enforceability of contracts would not cause prices to rise? By limiting opportunistic use of the bankruptcy system, the bankruptcy reform bill similarly reinforces the enforceability of contractual promises; after all, no one doubts that there is actually a contractual obligation involved. As such, it will have the same effect as increasing the enforceability of contracts generally. Most people believe that making contracts more easily enforceable tends to benefit all parties, including consumers. Thus, if one believes that greater enforcement of valid contracts generally reduces costs and benefits consumers, then it is equally obvious that consumers as a whole will benefit from greater enforcement of consumer credit contracts through restrictions on opportunistic bankruptcy use.

In a competitive market, consumer prices reflect changes in business costs. Consumer creditors unquestionably operate in competitive industries, thus changes in their costs will be reflected in changes in the bundle of price and non-price terms that they offer to consumers. *See* Todd J. Zywicki, "The Economics of Credit Cards," 3 *Chapman L. Rev*. 79 (2000). For instance, when interest rates were capped in the pre-Marquette era, issuers of consumer credit responded in a number of ways, including the imposition of substantial annual fees on consumers. These annual fees amounted to a redistribution from convenience users who paid their bills in full every month to those who revolved balances at below-market interest rates. Retailers who ran credit operations, such as large department stores, imposed the costs through charging higher prices for the goods they sold, sometimes offering "cash discounts" to those who did not buy the item on credit. In short, changes in the cost structure of credit issuers are reflected in the price and nonprice terms they charge.

Question 3: Should Congress include a trigger mechanism in S. 220 to make sure that consumers will benefit from lower credit costs as a result of bankruptcy reform legislation that will clearly benefit the credit industry by lowering its costs of doing business?

Answer: No. It would be impossible to predict how the consumer credit industry will respond to reductions in its bankruptcy losses and it would be unwise to force them to respond in a way calculated to satisfy political pressures rather than consumer preferences. Attempting to draft such a trigger would throw a blanket of uniformity over a market characterized by dynamic competition and strong consumer choice. Recent history indicates, for instance, that market competition has been driven by consumer demand for greater benefits, rather than reductions in credit prices. In the credit card industry alone, these benefits have included such a diverse array of services as cobranding benefits, frequent flyer miles, 24-hour customer service, anti-fraud protection, and car rental insurance. It is evident that these services are being supplied in response to customer demand, and that consumers have demanded these benefits in lieu of reductions in price terms. To paraphrase a recent observation from an article I with Judge Edith H. Jones, "Using [cost savings] as the only proxy for vigorous competition is tantamount to saying that the automotive industry is noncompetitive because car manufacturers increase quality through improved safety, comfort, or gas milage, rather than simply cutting prices." Edith H. Jones and Todd J. Zywicki, "It's Time for Means-Testing," 1999 *Brigham Young University L. Rev*. 177.

Question 6: You testified that there is a "growing sophistication among lawyers and the public about the opportunities for fraud and abuse—both legal and illegal—in the bankruptcy system." Please provide specific examples of these opportunities for, fraud and abuse—both legal and illegal.

Answer: It is generally understood by bankruptcy analysts that there is a substantial degree of abuse in the system. Many of the reforms included by the legislation are responsive to concerns identified by the National Bankruptcy Review Commission in its Report. This includes such abuses as improper serial filings and such things as the use of so-called "fractional interests" to frustrate the legitimate exercise of creditors' rights (see NBRC Recommendation 1.5.6). NBRC Recommendation 1.1.2 reflects the widespread concern about the inaccurate and misleading information provided by debtors on their schedules. Recommendation 1.1.4 expresses the concern that lawyers are not providing adequate oversight as to their clients behavior. Recommendation 1.4.4 evidences the Commission's concern that bankruptcy was being used improperly to avoid performance of spousal and child-support obligation. Even though many of the Recommendations of the National Bankruptcy Review Commission were quite contentious, there has been a broad consensus that these particular Recommendations are rooted in real-world concerns about fraud and abuse in the bankruptcy system. I am not aware of anyone who has questioned the NBRC's concerns about inaccurate schedules, fractional interests, and the like.

Moreover, it is evident that there are at least some individuals filing bankruptcy and receiving a discharge in chapter 7 that could repay some of their debts. Even if the figure is as low as 3%, this number is still greater than the current number of filers who have their cases dismissed for substantial abuse. For instance, Judge Newsome testified during the hearing that he has dismissed for substantial abuse less than 1% of the cases he has seen, which is substantially smaller than even the most modest estimates of what meanstesting would do. Professor Jack F. Williams, for instance, has observed that many perceive the anti-abuse provisions of § 707(b) to be a "dismal failure." See Jack F. Williams, "Distrust: The Rhetoric and Reality of Means-Testing," 7 *Am. Bankr. Inst. L. Rev*. 105 (1998).

In addition to this abuse, it appears that illegal activity has also increased in the bankruptcy system. In the past two years there has been large-scale criminal prosecutions in certain areas of the country that have demonstrated the presence of substantial illegal activity that is present in the consumer bankruptcy system. Consider some recent stories from the past year or so that have been reported in Bankruptcy Court Decisions:

- "Sixteen Charged in Bankruptcy Abuse Cases," Volume 35, Issue 8 (Jan. 11, 2000). "In the fourth bankruptcy fraud sweep in four years, 16 individuals from across Southern California have been charged with a variety of criminal violations arising form alleged misdeeds in bankruptcy cases."
- "Bankruptcy Fraud a Growing Problem Nationwide-In Maryland," Volume 36, Issue 2 (June 6, 2000). "Maryland U.S. Attorney Lynne A. Battaglia said her office is pursuing an increasing number of criminal bankruptcy fraud cases because this crime is a growing problem nationwide-and in Maryland."
- "L.A. Landlord Convicted on Three Counts of Bankruptcy Fraud," Volume 35, Issue 20 (April 4, 2000). "Bernard Gross of Los Angeles was convicted Feb. 16, after a two-week jury trial, on three counts of bankruptcy fraud for making false statements in his bankruptcy papers. 'Gross' false statements prevented the bankruptcy court from learning about other potentially related bankruptcy cases, and about properties and businesses that may have been connected with other bankruptcy filings,' said U.S. Trustee Maureen Tighe."
- "New Mexico Man Pleads Guilty to Wire Fraud in Connection with His Chapter 7," Volume 35, Issue 16 (March 7, 2000). "Gaylen Hindeldey, currently residing in Palm Sptings, Calif., pleaded guilgy Feb. 22 in district court in New Mexico to one count of wire fraud in connection with his 1992 Chapter 7. 'Hinkeldey attempted to use wire communications to hide more than $55,000 from his creditors,' said U.S. Trustee Brenda Moody Whinery."
- "Administrative Law Judge Convicted of Bankruptcy Fraud," Volume 35, Issue 15 (February 29, 2000). "Simona Flores Rosales, an administrative law judge for the California State Unemployment Insurance Appeals Board, was convicted Feb. 4 by a Federal District Court jury of five felony criminal counts, three counts of bankruptcy fraud, one count of money laundering and one count of filing a false income tax return. The jury found Rosales guilty of concealing assets and making false statements under oath during her bankruptcy proceedings."

These stories are merely illustrative and chosen at random, but are suggestive of the concerns over fraud and illegality in the system.

Question 5: Which provisions, if any, should be improved in S. 220? If there are provisions in S. 220 that should be improved, do you have any proposals, including legislative language, for the Committee?

Answer: The only possible improvement to the bill that I can identify would be an elimination of the broad safe harbor provisions of the means-test provisions of the legislation. This provision could potentially allow high-income debtors with substantial repayment capacity to escape the means-test.

Question 6: You testified that: "means-testing will have no effect on those making less than the minimum income threshold provided. Thus, for the 80% of filers whose income lies beneath the state median, means-testing will have no effect whatsoever." Is it not true that the new paperwork requirements in S. 220 that are intended to implement the bill's means-test apply to all personal bankruptcy filings?

Answer: Read in context, I believe it is clear that my testimony refers to the substantive elements of means-testing, not the procedural elements. Substantively, means-testing does not affect those who make less than the state median income. As for the question of whether increased paperwork will be required, I am not sure what specific paperwork the question refers to, nor am I aware of specific new paperwork that is supposedly the result of administering the means-test, as opposed to preventing other forms of fraud and abuse. Current bankruptcy schedules I and J already require the information on the debtor's income and expenditures that are required by the means-test. Thus, it is not clear what additional paperwork would be required to administer the means-test.

SUBMISSIONS FOR THE RECORD

AMERICAN BAR ASSOCIATION
GOVERNMENTAL AFFAIRS OFFICE
Washington, DC 20005–1022

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

Re: Bankruptcy Appellate Structure

Dear Mr. Chairman:

On behalf of the American Bar Association ("ABA "), I would like to thank you for the opportunity to submit the ABA's views regarding the bankruptcy appellate reform provisions contained in Section 1235 of S. 220, the "Bankruptcy Reform Act of 2001," and we request that the following comments be included in the record of the Committee's hearing scheduled for February 8, 2001.

The ABA, which has over 400,000 members throughout the country, strongly supports legislative provisions like Section 1235 that would allow direct appeals from orders of bankruptcy judges to the existing circuit courts of appeals. This is a nonpartisan proposal which would significantly improve the bankruptcy system. As Chair of the Business Bankruptcy Committee of the ABA Section of Business Law, I have been authorized to express the ABA's views to you on this important matter in an effort to improve the administration of the bankruptcy laws.

Direct appeal of bankruptcy matters to the regional circuit courts of appeals has also been recommended by the National Bankruptcy Review Commission ("Commission"), which studied the matter in depth. The Commission was composed of three members appointed by the President (then President Clinton), two members appointed by the Senate, two members appointed by the House of Representatives, and two members appointed by the Chief Justice.

Although the Commission was split on a number of the bankruptcy issues addressed in its Report, the recommendation for direct appeals of bankruptcy matters received the unanimous support of all of the Commission's members.

Under the current system of bankruptcy appeals, a bankruptcy order (unlike other federal trial court orders) is subject to an additional level of review: an appeal must go first to either a district court or a bankruptcy appellate panel ("BAP ") before the appeal may go to a circuit court. The two-level bankruptcy appellate process is extremely unusual. The ABA believes that this multi-tiered bankruptcy appellate structure works poorly. It imposes unnecessary delays and costs on all parties. In addition, as stated in the Judicial Conference's 1995 Long Range Plan for the Federal Courts: "Under current practice, district courts and BAY decisions are not treated as stare decisis in other cases—resulting in a 'patchwork' of differing legal interpretations that encourage forum shopping and undermine the national system of [a uniform] bankruptcy law." (p.48)

The ABA believes that a direct appeals system, designed to closely parallel the track of nonbankruptcy civil appeals, will result in:

- Faster final decisions;
- Greater certainty, uniform interpretation and decisions of precedential value with respect to key bankruptcy issues; and
- Reduction in unnecessary bankruptcy litigation.

The ABA believes that direct appeals will aid in achieving the important goal of reducing the time and costs associated with the bankruptcy process and will also assist in harmonizing bankruptcy laws and nonbankruptcy commercial laws generally.

When members of the National Bankruptcy Review Commission appeared before Congress on November 13, 1997, after submitting its Final Report, the Honorable Edith H. Jones of the U.S. Court of Appeals for the Fifth Circuit testified that: "Congress should adopt the Commission's unanimous recommendation that appeals from bankruptcy courts should be routed directly to the U.S. Court of Appeals, rather than through an intermediary such as the district courts or bankruptcy appellate panels. . .(and) *the importance of this measure cannot be overstated*." (emphasis in original).[1]

[1] "The current system which provides two appeals, the first either to a district court or a bankruptcy appellate panel and the second to the U.S. Court of Appeals, as of right from final orders

As noted in its commentary on the Recommendation: "The Constitution authorizes Congress to establish a uniform law of bankruptcies. Despite this clear constitutional mandate, the current bankruptcy appellate structure has yielded results which are far from uniform.* * *Concerns over costs and efficiency also support the Recommendation. Under the current system, every bankruptcy appeal is an expensive excursion for both debtor and creditor who must work through two layers of appeal for a final resolution of their disputes. *Final Report* at 753–54.

Both the ABA and the National Bankruptcy Review Commission recognize, and are sensitive to, the possibility of increased workload for the circuit court judges. After examining and analyzing the issue, however, the Commission concluded that, while direct appeals may temporarily increase the workload by approximately 9%, "over time. . .this number should decrease as more issues are settled within the circuit and fewer uncertainties linger, necessitating fewer appeals." (A copy of the relevant portions of the Commission's Final Report to Congress is enclosed for your convenience.) The Commission concluded that the substantial long-term benefits of a direct appeals system significantly outweigh any modest short-term burdens, and the ABA agrees with this conclusion.[2]

Section 1235 of S. 220 would allow for direct appeals in most bankruptcy cases. Under this provision (which is identical to the corresponding provision in H.R. 2415, the bill approved by Congress last year but vetoed by President Clinton), bankruptcy appeals initially would be routed to the district courts for a 30-day period. After the 30-day period, the appeals would automatically proceed to the regional court of appeals if the district court had not ruled or entered an order extending such 30-day period or if the parties had not consented to the retention of the appeal in the district court beyond the 30-day period.

Section 1235 was designed to address concerns that some litigants may prefer to keep the appeal in the district court and that the district court should be given some latitude to keep the appeal. Although the ABA prefers a pure direct appeal system for the bankruptcy courts that is the same as the system used in the other federal trial courts, the proposed alternative is acceptable to the ABA and we view it as a clear improvement over current law. In essence, this alternative would permit direct appeals to the circuit courts in most cases, except where the district court ruled during the 30-day period, the parties otherwise consented, or the district court extended the 30-day period.[3]

Question 1157(e). Also, a district court may withdraw the reference to a bankruptcy judge for cause. 28 U.S.C. § 157(d).

The bankruptcy system affects the lives of many Americans, whether as debtors or as creditors or as employees of companies undergoing reorganization. The ABA believes that direct appeals to the regional circuit courts of appeals is an important component of bankruptcy reform. It is fair and beneficial to all parties; it will help achieve uniformity; and it will help harmonize bankruptcy and nonbankruptcy commercial law. For these reasons, the ABA urges the Committee to support Section 1235 of S. 220.

Thank you for your consideration, and if you would like to discuss the ABA's views on the bankruptcy appellate structure in greater detail, please feel free to contact me at (212) 4557140 or Larson Frisby in the ABA Governmental Affairs Office at (202) 662–1098.

Sincerely,

M. O. SIGAL, JR.

cc: Members, Committee on the Judiciary

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in bankruptcy cases, should be changed to eliminate the first layer of review." National Bankruptcy Review Commission, *Final Report*, Recommendation 3.1.3 at 752–53 (1997).

[2] In its 1995 Long Range Plan for the Federal Courts, the Judicial Conference stated that the appellate review of orders of bankruptcy judges should be studied to "ensure prompt, inexpensive resolution. . .and foster coherent, consistent development of bankruptcy precedents." Recommendation 21 at 47. It was recommend that statutory change "should await the [National Bankruptcy Review Commission's] report in that respect. *Id* at 48. As noted above, the Commission unanimously recommended direct appeals.

[3] Several other provisions of the present Judicial Code relating to bankruptcy jurisdiction already hinge on the consent of the litigants or orders entered for cause. For example, if a circuit has established a bankruptcy appellate panel, appeals can go to the BAP only with consent of the parties. 28 U.S.C. § 158(c)(1). A jury trial can be conducted by a bankruptcy judge only with the consent of the parties. 28 U.S.C.

Statement of Hon. Richard S. Arnold, U. S. Circuit Judge for the Eighth Circuit

Mr. Chairman and Members of the Committee:

I make this statement at the request of your staff, who got in touch with me by telephone on the afternoon of Monday, February 5. I understand that the Committee is holding hearings on pending bankruptcy legislation, including a provision that would allow for direct appeal from bankruptcy courts to the courts of appeals, instead of the current appellate structure, which is three-tiered, including bankruptcy courts, either district courts or bankruptcy appellate panels, and courts of appeals.

I understand that the Judicial Conference of the United States is not in favor of the direct-appeal proposal. It is with some reluctance that I voice a different view, the more so as the position of the Judicial Conference is to be stated by Chief Judge Becker of the Third Circuit, whom I respect and admire as much as any judge in the country. Nevertheless, you have asked my opinion, and I believe that, as a citizen and an officer of the United States, I should respond to such a request from Congress.

Some time ago, during the deliberations of the National Bankruptcy Review Commission, I was asked to appear before the Commission and give my views on certain subjects. Among other things, I expressed the opinion that the current complicated appeal process should be replaced by a simple system of direct appeals from bankruptcy courts to the courts of appeals, with further discretionary review by the Supreme Court, of course. I have not changed my opinion since that time, and desire to state briefly the reasons why. The statement will be very brief indeed, as I have not had much time to prepare it.

For a litigant to have two appeals as of right is very unusual in, the federal system. It has always seemed odd to me that such a provision should obtain in bankruptcy cases, of all places, where, by hypothesis, assets are limited. Most litigants in bankruptcy fall into one of two broad categories: people who cannot pay their debts, and creditors who are destined to receive less than full payment. Every dollar that goes into litigation is a dollar that the creditors will not receive. For this reason, it seems to me that, in bankruptcy above all other areas, simplicity and reduction of expense should be the order of the day. Yet, largely for historical reasons, this is not the case.

The best solution to any problem is usually the simplest one. In this instance, the simplest solution is to provide for appeals from bankruptcy courts directly to the courts of appeals. Under the current system, appeals from bankruptcy courts go either to the district courts or to bankruptcy appellate panels. Thereafter, unhappy litigants are given a second appeal, as of right, to the courts of appeals. Cases are prolonged, and expense is multiplied. I suggest that a direct appeal to the court of appeals is the best solution to this problem, because the courts of appeals, after all, are in the appellate business all the time. If there is anything we know how to do, this is it.

I do not for a moment depreciate the work done by the district courts and the bankruptcy appellate panels in bankruptcy appeals. I have no criticism of the quality of their work. I have never understood, however, why bankruptcy appeals should be so much more complicated than appeals in other kinds of cases. If the Congress is not inclined to create a single system of direct appeals to the courts of appeals, perhaps it could leave in place the existing appellate system, but make the second step discretionary. Under such a system, the courts of appeals would have discretion, akin to that exercised now by the supreme Court on petitions for certiorari, to hear, or not, appeals in bankruptcy cases that have already received one appeal as of right.

The downside of the direct-appeal idea, of course, is that it would load more cases into the courts of appeals, which are already overloaded. The solution, I suggest, is more judgeships. If more judges are needed to do the appellate work in an orderly and thorough fashion, and I believe they are, then Congress should create them. The addition of direct bankruptcy appeals to the work load of the courts of appeals would furnish one more reason for the creation of these new judgeships.

Mr. Chairman, I appreciate your allowing me to submit this statement in writing. If there is any way in which I can be of further service to you or to the Committee, please don't fail to let me know.

RICHARD S. ARNOLD

Statement of Association of Financial Guaranty Insurors

Mr. Chairman, the Association of Financial Guaranty Insurors (AFGI), a trade association of financial guaranty insurors [1], appreciates the opportunity to submit testimony to the Committee on suggested revisions to the United States Bankruptcy Code related to asset-backed securities. AFGI fully supports H.R. 220, but we would like to limit our remarks to the provisions included in Title IX, Section 912 that relate specifically to asset-backed securities.

AFGI has supported the revisions incorporated in Title IX, Section 912 of S. 220 for several years. Through outside counsel, our Association submitted recommendations to the National Bankruptcy Commission in 1997; submitted testimony for the hearing record when the House Committee on the Judiciary's Subcommittee on Commercial and Administrative Law held hearings in the 105th and 106th Sessions of Congress; and testified before this Committee's Subcommittee on Administrative Oversight and the Courts in 1998.

PURPOSE OF THE PROPOSED CHANGE TO THE BANKRUPTCY CODE

AFGI believes that the suggested revisions incorporated in Title IX of S. 220 relating to asset-backed securities reduces uncertainty under the Bankruptcy Code as it applies to the almost $200 billion per year of asset-backed securities issued in the United States. By reducing uncertainty, the proposed amendment will increase stability in the capital markets and thereby facilitate asset-backed financings and eliminate certain risks which otherwise indirectly increase interest rates for millions of consumers, small business and others seeking financing from the capital markets. The proposed revision is constructed to achieve these benefits without impairing any of the reorganization and fairness policies underlying the Bankruptcy Code.

APPLICATION OF THE PROPOSED CHANGE

The proliferation of asset-backed securities in the United States over the past two decades has dramatically increased both the number of lenders and the lending capacity of existing financial institutions. This increased capacity has, in turn, created intense competition for borrowers.

Today, consumers and small businesses have more choices when looking for a home, auto loan, a new credit card, or financing for a small business. More significantly, consumers and small businesses whose credit posed too great a risk to qualify for financing are now, in many cases, able to do so. This is because, in an asset securitization, loans and other receivables are sold by lenders to a company formed to sell securities in a structure which takes into account the credit risks posed by these receivables. The sale proceeds paid to the lender enable it to fund the "securitized assets" to make additional loans to consumers and small businesses.

The company to which lenders sell their loans or other receivables (the "Securitized Assets "), will typically be a "bankruptcy remote entity." The company's activities are restricted to the purchase and ownership of the Securitized Assets and issuance of the securities. Following its acquisition of the loan assets or other receivables, the bankruptcy remote entity will typically issue debt or other securities—the asset-backed securities—backed by Securitized Assets. By bankruptcy-remote, we simply mean that the company is required to maintain an existence that is completely separate from its affiliate companies such that it will not be affected by the bankruptcy of an affiliate.

Generally, the cash flow or other proceeds generated by the Securitized Assets are sufficient to pay the amounts due on the asset-backed securities. In certain instances credit enhancement is provided by third parties, including members of AFGI, guaranteeing the timely payment of amounts due to the holders of the asset-backed securities.

Under current law, uncertainty can arise when the transfer of the Securitized Assets by the lender or its operating company to the bankruptcy remote entity is deemed to be something other than a sale. If the transfer is not a sale and if the seller of the loan assets seeks relief under Chapter 11 of the Bankruptcy Code, the Securitized Assets purported to have been transferred to the bankruptcy remote entity may be included in the seller's bankruptcy estate. In that event, the cash flow

[1] The members of AFGI are AMBAC Indemnity Corporation, AXA Re Finance S.A., Capital Reinsurance Company, Enhance Reinsurance Company, Financial Guaranty Insurance Company, Financial Security Assurance, Inc, and MBIA Insurance Corporation.

or other proceeds generated by the Securtized Assets (i) would be subject to the automatic stay provision of the Bankruptcy Code and would not be available to pay the holders of the asset-backed securities until relief was obtained from the automatic stay, and (ii) could be subject to cramdown or collateral substitution that would further impair the bankruptcy remote entity's ability to pay amounts due on the asset-backed securities.

Any interruption or impairment of the cash flow or proceeds resulting from the application of the automatic stay, cramdown or collateral substitution, impairs the market value of the asset-backed securities and, in the case of insured asset-backed securities, requires the insurer of these securities to pay the amounts due the holders thereof which would otherwise have been paid by the bankruptcy-remote entity.

A "true sale" opinion is a fundamental requirement of every asset securitization. It is a "reasoned" opinion of legal counsel to the effect that the assets "sold" by an originator to the issuer of asset-backed securities will not be impaired in the event of the subsequent bankruptcy of the originator. The current Bankruptcy Code injects uncertainty into this opinion because it does not provide any clear guidance on what constitutes a "true sale." Attached is a copy of a letter and an exhibit of a "true sale" opinion that was rendered in a recent asset-backed transaction rated by two rating agencies that the Association delivered to Senator Grassley following the 1998 Senate hearing (Appendix 1). Both our letter to Senator Grassley and the "true sale" opinion more fully describe and illustrate the pressing need for the asset-backed security provision set out in Section 912 of S. 220.

THE PROPOSED REVISION

In order to address the situation, in which the seller of loans or other receivables commences a Chapter 11 case under the Bankruptcy Code, the proposed change in Title IX, Section 912 of S. 220 prevents the Securitized Assets transferred to the bankruptcy remote entity from being included in the seller's bankruptcy estate. This enables the bankruptcy remote entity to continue using the cash flow or other proceeds from the Securitized Assets to make payments to the holders of the asset-backed securities. To the extent, if any, that the bankruptcy remote entity owes any amount to the seller, that obligation remains valid and the seller can obtain payment of that amount in accordance with its original terms.

The revision to Section 541 of the Bankruptcy Code contained in Title IX, Section 912 of S. 220 is limited in its application to preventing the Securitized Assets conveyed by the seller to the bankruptcy remote entity from being included in the seller's bankruptcy estate. Thus, the proposed amendment simply confirms that the transfer intended by the parties as a sale will not be unwound and the reorganization of the bankrupt seller will not be otherwise impaired. Furthermore, the proposed amendment is limited to transactions involving the issuance of investment-grade, asset-backed securities, since a primary purpose of Section 912 is to protect the legitimate expectations of investors in asset-backed securities sold in the capital markets. In addition, as explained in greater detail in the commentary at Appendix 2, limiting the application of the proposed amendment to securitized transactions in which one class or tranche of securities are rated investment grade substantially reduces the possibility that a lender or its operating company could transfer some or all of its loan assets or other receivables to a bankruptcy remote entity in an effort to defraud creditors of the company. In addition, Section 912 provides that securitized assets may be included in a debtor's bankruptcy estate to the extent such assets may be recoverable by the bankruptcy trustee under Section 550 of the Bankruptcy Code by virtue of evidence as a fraudulent conveyance under Section 548 (a).

AFGI strongly supports the revisions to Section 541 of the Bankruptcy Code contained in Section 912 of H.R. S. 220 relating to asset-backed securities. We believe the proposal will provide increased certainty to investors and other participants in the asset-backed securities market which, in turn, will create further stability in the capital markets, and facilitate future asset-backed financings. All of this will help maintain and foster an efficient funding source for mortgage loans, credit card receivables, automobile loans, and other loans available to citizens in small rural communities as well as our nation's cities. Section 912 will ensure that consumers small businesses and others have the opportunity to access the least expensive source of financing, the capital markets.

FORDHAM UNIVERSITY
New York, NY

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

Dear Mr. Chairman,

Thank you for the opportunity to state my views regarding the bankruptcy appellate reform provisions contained in Section 1235 of S. 220, the "Bankruptcy Reform Act of 2001." I respectfully request that these remarks be included in the record of the Committee's hearing scheduled for February 8, 2001.

Section 1235 would enlarge the jurisdiction of the courts of appeals to permit direct review of certain bankruptcy court orders. Providing a route for parties directly to appeal the final judgments, decisions, orders, and decrees of bankruptcy courts will improve substantially the expeditious administration of bankruptcy cases and the ability of the bankruptcy appellate system to develop binding precedent.

Bankruptcy appeals should be resolved as quickly as administratively feasible since delay in the resolution of a bankruptcy case invariably reduces distributions to creditors.[1] The opportunity for a direct appeal to the court of appeals provided under section 1235 would enable litigants who would in any event desire circuit court review to avoid the needless delay and expense attendant to a dual appeal system.[1]

The existing two-tiered bankruptcy appellate system undermines the development of stare decisis—binding precedent—in the bankruptcy context.[3] While it is clear that the decision of a court of appeals binds every federal court within the circuit, courts are irreconcilably divided as to whether the appellate decisions of federal district courts or bankruptcy appellate panels are binding precedent for the circuit. The inability to create binding precedent undoubtedly creates a substantial reduction in the benefits of appellate review. If lawyers and others cannot predict the state of the law on important bankruptcy-related topics, they may be unable to advise clients in structuring transactions or settling litigation. Enabling parties the ability to appeal certain bankruptcy court orders directly to the courts of appeals would improve significantly this lack-of binding-precedent problem in the bankruptcy system.[4]

Two criticisms of proposals to enable direct review of bankruptcy appeals in courts of appeals have exaggerated the possible detrimental effects of this bankruptcy appellate reform.

First, some argue that enactment of section 1235 would inundate courts of appeals with direct bankruptcy appeals. Careful studies of the likely effect of bankruptcy appellate reform on appellate filings predict relatively mild increases in the workload of courts of appeals, however. Specifically, the Federal Judicial Center, in its recent report on ALTERNATIVE STRUCTURES FOR BANKRUPTCY APPEALS, projected that proposals to eliminate intermediate level appellate review of bankruptcy court decisions (namely, the proposal made by the National Bankruptcy Review Commission) would affect total appellate filings by between 6.9 and 4.5 per-

[1] As early as 1845, the Supreme Court indicated that the "manifest object" of the federal bankruptcy laws was to provide speedy proceedings, and the ascertainment and adjustment of all claims and rights in favor of or against the bankrupt's estate, in the most expeditious manner. Ex pane Christy, 44 U.S. (3 How.) 292, 314–15 (1845); *see also Bailey* v. *Glover*, 88 U.S. (21 Wall.) 342, 346 (1874) ("It is obviously one of the purposes of the Bankrupt law [of 1867] that there should be a speedy disposition of the bankrupt's estate ").

[2] A recent study conducted by the Federal Judicial Center concluded that, [f]or cases that continue on through the court of appeals, the time spent at the district covet or BAP adds substantially to the total time on appeal—for cases terminated on the merits by the courts of appeals in fiscal 1998, the average time spent in the total appellate process was more than 27 months (826 days), and the median time was more than 22 months (663 days). Judith A. McKenna & Elizabeth C. Wiggins, ALTERNATIVE STRUCTURES FOR BANKRUPTCY APPEALS at 3 (Federal Judicial Center 2000).

[3] [Dan Bussel]

[4] (may not be the only method but probably the most politically feasible method] ASBA at 7–8.

cent, with their "best estimate" at the low end of this range.[5] These figures compare favorably to 9 percent increase in appellate filings estimated by the National Bankruptcy Review Commission in their Report to Congress.[6]

It is important to emphasize, moreover, that both the projections of the National Bankruptcy Review Commission and the Federal Judicial Center attempt to assess the effect on courts of appeals of eliminating intermediate levels of review for all bankruptcy appeals, a result that section 1235 of S. 220 does not seek to obtain. Section 1235 instead would permit direct review by court of appeals only of bankruptcy court orders as to which the district court has not, within a 30-day period, rendered an appellate decision or entered an order extending this period for cause. In addition, both of these projections estimate the immediate affects of bankruptcy appellate reform on the workload of courts of appeals. In the long term, however, direct filings should diminish as courts of appeals develop a clearer and more predictable body of stare decisis in bankruptcy.

Second, some have argued that bankruptcy appellate reforms proposing to permit direct bankruptcy appeals to courts of appeals would subject bankruptcy courts' current exercise of jurisdiction to the claim that it is unconstitutional.[7] Of course, any change to the complex balance of interests found in the existing bankruptcy jurisdictional provisions might invite spurious constitutional challenge, but I believe that section 1235 easily would withstand constitutional scrutiny.[8] Supreme Court precedent clearly identifies de novo review, rather than ordinary appellate review, as critically important to the conclusion that an adjunct court's exercise of authority complies with constitutional requirements. For example, in *U.S.* v. *Raddatz*,[9] the Supreme Court upheld the delegation of authority to untenured magistrates under 28 U.S.C. § 636(c)(1) as constitutional and, in so doing, emphasized that "Congress has provided that the magistrate's proposed findings and recommendations shall be subjected to de novo determinations 'by the judge who. . .then exercise[s] the ultimate authority to issue an appropriate order." Similarly, in *Thomas* v. *Am*,[10] the Court rejected the argument that a rule viewing a failure timely to object to a magistrate judge's decision as a waiver of appellate review would violate Article III on these terms, emphasizing that

> [t]he waiver of appellate review does not implicate Article III, because it is the district court, not the court of appeals, that must exercise supervision over the magistrate.[11]

Moreover, it is important to re-emphasize that section 1235 would not altogether eliminate intermediate appellate review of bankruptcy orders. It would provide for direct review by courts of appeals only in the event that a district court did not enter, within a 30-day period, either a decision on the appeal or an order extending such period for cause. Presumably, a significant percentage of district courts will be able to render their appellate decisions within this 30-day period. In addition, section 1235 would require all parties to the appeal to consent to direct review by the court of appeals. The Supreme Court repeatedly has emphasized the significance of litigant consent in this context in that, much like other constitutionally protected individual rights, an individual's interest in a fair and independent judiciary is subject to waiver.[12]

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[5] Judith A. McKenna & Elizabeth C. Wiggins, ALTERNATIVE STRUCTURES FOR BANKRUPTCY APPEALS at 55–59 (Federal Judicial Center 2000).

[6] National Bankruptcy Review Commission, Final Report at 753–54 (1997).

[7] During the 105th Congress, for example, the Department of Justice voiced its objection to section 411 of H.R. 3150 (which would have eliminated all intermediate levels of review of bankruptcy court orders), urging Congress "not to lessen district court review and remove this potentially significant basis for the constitutionality of the bankruptcy court's exercise of judicial power" Letter from Ann N. Harkins, Acting Assistant Attorney General, to Rep. Henry J. Hyde (May 7, 1998). Section 411 did not survive the conference on H.R. 3150. *See also John P. Hennignan, Jr., The Appellate Structure Regularized: The NBRC's Proposal*, 102 DICK. L. REV. 839 (1998) ("There is a plausible argument that the constitutionality of the present system depends upon classifying bankruptcy judges as adjuncts to the district courts and bypassing those courts on appeal obviates that classification.").

[8] For a more detailed discussion of these constitutional issues, see Susan Block-Lieb, Assessing the Constitutionality of Proposed Reforms to the Bankruptcy Appellate Process, Appendix C to Judith A. McKenna & Elizabeth C. Wiggins, ALTERNATIVE STRUCTURES FOR BANKRUPTCY APPEALS at 93–107 (Federal Judicial Center 2000).

[9] 447 U.S. 667 (1980).

[10] 474 U.S. 140 (1985).

[11] Id. at 153–54. See also *Briney* v. *Burley*, 738 F.2d 981, 986 (9th Cir. 1984) ("Because there is no constitutional right to an appeal,. . .a fortiori there is no constitutional right to two levels of appeal. . .by an Article III judge.").

[12] See, e.g, *Commodity Futures Trading Comm'n* v. *Schor*, 478 U.S. 833, 850 (1986).

The process by which bankruptcy appeals are resolved is critically important to the administration of bankruptcy cases. Section 1235 of S. 220 represents a cautious improvement over the existing arcane bankruptcy appellate provisions in that it would, under limited circumstances, permit courts of appeals directly to review certain bankruptcy court orders. Direct review would expedite resolution of bankruptcy appeals and strengthen both the quality and quantity of binding bankruptcy precedent. Direct review would not deluge courts of appeals with bankruptcy appeals and would not render the bankruptcy court system unconstitutional.

Thank you for your consideration. Should you have further questions on my views regarding these or other bankruptcy appellate reforms, please feel free to contact me at (212) 636–6782.

Sincerely,

SUSAN BLOCK-LIEB

Statement of the Bond Market Association

The Bond Market Association appreciates the opportunity to comment on proposed reforms to the bankruptcy laws. The Bankruptcy Reform Act of 2001 (S. 220) 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 for approximately 97 percent of the nation's bond underwriting activity.

We commend Senator Hatch for calling this hearing and for his commitment to comprehensive bankruptcy reform early in the current congressional session. Last year's bankruptcy bill passed both houses of Congress by wide margins, and we are hopeful that this year's bill will be enacted quickly.

In this statement, the Bond Market Association focuses on provisions in S. 220 concerning cross-product netting, closeout rights and asset-backed securities (ABS).

I. INTRODUCTION

Certain financial transactions involve ongoing economic relationships or commitments to be fulfilled in the future. For example, risk management tools such as forward contracts and swaps are based on contractual agreements between parties to transfer assets or payments at some future time. Repurchase agreements, which are important sources of liquidity in the debt markets and, to an increasing degree, in the equity markets, involve financial commitments that must be fulfilled at a later date. 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 by undermining the financial condition of the nonbankrupt 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 almost 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 Bankruptcy Code should also be amended to protect and enhance the important role of the asset-backed securitization process. Asset securitizations, which provide a secondary market for mortgage, consumer, commercial and industrial loans and other debt obligations, are multi-stage transactions where the integrity of securities payment commitments rests on the finality of earlier transfers of underlying assets. An efficient secondary market for debt obligations lowers the cost and increases the availability of capital. This translates into more jobs for Americans. Amendments to increase market efficiency and provide comfort for investors will not only enhance the development of future asset-backed securitizations, they will provide a safeguard against market turmoil should a seller of financial assets become the subject of proceedings under the Bankruptcy Code and attempt to disrupt the cash flow on assets that were securitized.

The comprehensive bankruptcy bills currently pending in Congress would substantially improve the statutory regime that governs financial transactions when a party fails to meet its payment obligations. The Bankruptcy Reform Act of 2001 (S. 220) and the Bankruptcy Abuse Prevention and Consumer Protection Act (H.R. 333) are identical to the bankruptcy conference report that was approved by a wide bipartisan majority in the House and Senate last year.

This legislation would harmonize the Bankruptcy Code and bank insolvency laws governing swaps, repurchase agreements, securities contacts, forward contracts, and commodity contracts. They would also provide a safe-harbor in the Bankruptcy Code for ABS transactions. 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 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 future 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 pay the cash-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.

According to published reports, on an average day in 2000, nearly $1.4 trillion in repos were outstanding between dealers of U.S. government and federal agency securities, up from a daily average of $310 billion in 1988. Parties also routinely engage in repo transactions involving non-agency mortgage-backed securities, whole loans and other financial instruments. As a result of recent legislative changes enacted as part of the National Securities Markets Improvement Act and recent changes to federal margin regulations, repos may now involve equity securities. Participants in the repo market are diverse, including commercial banks, securities firms, thrifts, finance companies, nonfinancial corporations, state and local governments, mutual and money-market funds and the Federal Reserve Banks, among others.

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. 333 and S. 220, 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 "crossproduct" 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. 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. Mortgage- and Asset-backed Securities

The process of assembling pools of financial assets and selling securities with payments derived from the assets' cash flows is known as "securitization." Almost any financial asset can be securitized. The earliest examples were home mortgage loans, but today financial services firms securitize car loans and leases, credit card receivables, business loans and many other assets generating current or future cash flows. The proceeds from sales of securities supported by those assets make their way back into the capital markets and become available for new lending to homeowners, car owners, consumers, businesses and myriad other borrowers. A larger supply of lendable capital means that home buyers, car buyers, consumers and companies can all borrow at lower interest costs. A simple example demonstrates the process of financial asset securitization:

Example 8. Party O originates mortgage loans with a total principal amount of $100 million and sells the whole loans to a special-purpose vehicle (an "SPV "). The SPV issues mortgage-backed securities ("MBS "), the payments on which are supported by cash flows from the mortgage loans. As borrowers make principal and interest payments on their mortgage loans, these payments pass through a servicer and eventually are distributed to the MBS investors. The proceeds of the sale of the loans by Party O to the SPV are available for new loans to home buyers.

Certain types of mortgage-backed and asset-backed transactions raise issues under the Bankruptcy Code that make them more costly or difficult to complete. The central issue in such situations is the risk that securitized assets transferred to a special-purpose vehicle, which then issues securities backed by such assets, will be considered part of the bankruptcy estate of the party selling them into the pool if that seller becomes insolvent. Such treatment could subject the cash flows from the securitized assets to the automatic stay and inhibit the timely distribution of principal and interest payments to investors in the subsequently issued asset-backed securities. It could also subject the pool of transferred assets to attack by a bankruptcy trustee who might seek to reclaim them for the bankrupt's estate for the benefit of general creditors, denying beneficial holders of asset-backed securities the primary source of repayment that was intended to be provided by these securitized assets. Consider the following transaction:

Example 9. Party A originates mortgage loans with a total principal amount of $100 million and sells the loans to Party B. Party B sells two classes of asset-backed securities based on the pool. The Class A securities, totaling $90 million, have a senior claim on the cash flows generated by the mortgage loans and receive an investment-grade credit rating. The Class B securities, totaling $10 million, are subordinated to the Class A securities and not rated investment-grade. Assume Party B obtained the mortgage loans from Party A in exchange for (i) the $90 million raised through the sale of the Class A securities and (ii) the Class B certificates. If Party A becomes insolvent, Party A (as debtor-in-possession) or its trustee could attempt to recharacterize the sale of the mortgage loans as a pledge to secure a financing, based on Party A's retention of the Class B securities. If it were successful, notwithstanding that it had received fair value at the outset of the transaction and the reasonable expectations of the investors in the Class A securities, distribution of the principal and interest payments on the loans to the investors would be subject to the automatic stay, jeopardizing timely payment to the Class A investors. Such a result would not only harm the particular investors in question, it could have a material, negative effect on the mortgage-backed and asset-backed securities markets more generally.

In order to obtain sales treatment under the relevant accounting standards, participants in mortgage-backed and asset-backed securitization transactions must obtain assurances from counsel that the sale of assets will be final under applicable bankruptcy law. Such legal advice is referred to as a "true sale opinion." Unfortunately, there is a lack of guiding judicial precedent regarding what constitutes such a true sale of assets. The considerations in the analysis are highly subjective and depend on a qualitative assessment of a wide variety of facts and circumstances. For these and other reasons, any true sale opinion will generally be a reasoned one, with various assumptions as to factual matters and conclusions that introduce an unnecessary degree of legal uncertainty in the asset-backed market. As a result, for some types of transactions, true sale opinions can be extremely difficult, costly, and in a few cases, impossible to render.

The FDIC recently released for comment a proposed Policy Statement that would clarify that, with respect to certain securitizations by FDIC-insured institutions, the FDIC would not seek to reclaim assets that were the subject of the securitization. In particular, the Policy Statement "provides that subject to certain conditions, the FDIC will not attempt to reclaim, recover, or recharacterize as property of the institution or the receivership estate. . .the financial assets transferred. . .in connection with the securitization." 63 Fed. Reg. 71926 (December 30, 1998). Similar action is needed to cover transfers by market participants who later become debtors under the Bankruptcy Code. In an effort to clarify the rights of investors in asset-backed securities and bring the benefits of securitization to a broader spectrum of market activity, H.R. 333 and S. 220 include a series of amendments to the Bankruptcy Code that would specifically exempt certain transferred assets from a debtor's bankruptcy estate and clarify whatever "true sale" confusion may exist. The amendments would be narrowly tailored to apply only to eligible assets transferred as part of a bona fide securitization involving the issuance of securities rated investment grade by at least one nationally recognized rating organization. Through a series of definitions, the proposed amendments would exclude from a debtor's estate any asset "to the extent that such eligible asset was transferred by the debtor, before the date of commencement of the case, to an eligible entity in connection with an asset-backed securitization."

These changes would not only reduce transaction costs for future mortgage- and asset backed securitizations, they would minimize the likelihood that an insolvent debtor could attempt to reclaim already—securitized assets in a proceeding under the Bankruptcy Code, notwithstanding the structural safeguards designed to avoid such a result. Even if such a debtor were not successful, the possibility of recharacterization could have a significant adverse impact on the markets in mortgage- and asset-backed securities.

IV. CONCLUSION

The above examples illustrate the need for Congress to enact the financial contract provisions of S. 220 and H.R. 333, 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.

Statement of Commercial Law League of America

The Honorable Orrin G. Hatch
Chairman of the Judiciary Committee
The United States Senate
131 Russell Senate Office Building
Washington, DC 20510

Dear Senator Hatch:

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 in interest.

The Bankruptcy Section of the League 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.

In the Senate and the House of Representatives, S. 220 and H.R. 333 have been respectively introduced to reform the nation's bankruptcy laws. Each is virtually identical to H.R. 2415, which passed the 106th Congress, but did not become law due to a presidential veto. Although the League has prepared a position paper addressing its foremost substantive concerns with S. 220 and H.R. 333, we believe it is necessary to address procedural and substantive concerns that have arisen in that past and that, in all likelihood, will persist as S. 220 and H.R. 333 are considered.

Last session's H.R. 2415 reflected a compromise between H.R. 833 and S. 625, each of which passed its respective Congressional house but with some significant substantive differences. Unfortunately, the compromise that produced H.R. 2415 was not the product of reasoned debate because the legislation was never considered by a conference committee consisting of members of the Judiciary Committee.

The need for a full conference cannot be overemphasized. Bankruptcy law and legislation is highly specialized and complex, requiring intimate knowledge of the inner workings of the Bankruptcy Code and Rules, and their interrelationship among the various parties in interest. Further, to the League's knowledge, not a single bankruptcy organization, judges group or academicians has endorsed the current versions of the bills or their predecessors. Most disturbing is that the recommendations of the Bankruptcy Review Commission have been all but ignored in the current legislation.

While extensive attention has been given to the consumer aspects of bankruptcy reform, the business bankruptcy provisions have varied from bill to bill and have not been afforded the same deference. With an economic downturn already occurring, business bankruptcies inevitably will rise, making it more critical that any business bankruptcy reform be well reasoned and fully considered.

The business provisions of H.R. 833 and S. 625 were fundamentally flawed. As extensively addressed in the League's previous position papers, both pieces of legislation created far more problems than they remedied. These problems are carried forward in the recently re-introduced versions of H.R. 833 and S. 625.

For example, the legislation creates an untested procedure for the reorganization of small businesses. The problems begin with the commencement of the bankruptcy case be case the definition of "small business," tied to the amount of debt, would include an overwhelming majority of all business bankruptcies. Designed with a preference for efficiency over practicality, the small business provisions completely ignore the realities involved and will effectively eliminate the possibility of an otherwise viable reorganization in a great number of cases, causing creditors to go unpaid and workers to lose their jobs.

Retail bankruptcies are doomed to failure. The proposed legislation grants lessors of commercial real estate virtual veto power over lease assumption and rejection, rather than allowing the bankruptcy courts to continue to exercise their discretion regarding the time necessary for a debtor to make decisions about whether or not to retain leased property. Lessors will, in all likelihood, use their extraordinary power to exert concessions from debtors as the *quid pro quo* for the requested extensions, to the detriment of all other parties in interest. This protection is, of course, in addition to the already preferential treatment that commercial real estate lessors currently enjoy under the Bankruptcy Code, which requires debtors to timely remit lease payments or risk eviction from the premises. Equally disturbing is that lessors' administrative expense claims are proposed to be expanded. This further enhances lessors' 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.

Most critically, the legislation does not address the single largest defect in the business bankruptcy process—venue. The corporate chapter 11 has become an embarrassment to our system of law. Due process considerations have been undermined and access to the courts by creditors and parties in interest has effectively been eliminated, based on a debtor's current ability to file in its state of incorporation, rather than where its principal assets or principal place of business is located. This has resulted in over 40%of the business bankruptcy cases filed in 1999 having been filed in Delaware. Delaware courts are now determining from a remote location, issues which directly impact the community where the debtor is actually located and conducts its business. The inequitable nature of this process is heightened, as the largest bankruptcy cases are now being filed in Delaware. Whole communities, which are dependent on these mega-employers, are affected without having any local presence or real access to the process. Taxing authorities, who do not routinely utilize "local counsel" are being railroaded in the claims process, to the detriment of their citizens. Local community issues, such as hospital bed availability, nursing home care and public services such as garbage removal and utility service, are being determined by those who are least affected by the bankruptcy courts. Public confidence in the bankruptcy process is eroding, and justifiably so, when "notice" and "an opportunity to be heard" are nothing but hollow gestures.

These and a plethora of other troublesome provisions demonstrate the inherent complications involved in the process of reforming the Bankruptcy Code on the scale contemplated by the most recent bankruptcy reform legislation. The please of those with an intimate understanding of the bankruptcy system, including judges, practitioners, trustees, and academics, to more carefully consider the effects of the reform legislation have repeatedly fallen on deaf ears. Bankruptcy reform generally has yet to be debated in an appropriate conference, independent of other legislation, where its problematic aspects can be considered, including proper analysis of the harmful, unintended consequences that surely will befall debtors, creditors and the process as a whole. Real bankruptcy reform need not be so disruptive and should never depart so far from the longstanding and bedrock principle of bankruptcy—fair and balanced treatment of all parties in interest.

The League appreciates the opportunity to set forth and discuss these significant concerns regarding proposed bankruptcy reform and the process by which such reform is being considered. We welcome the invitation to work with you and the other members of Congress to achieve effective, balanced and meaningful bankruptcy reform for all parties in interest.

Respectfully submitted,

JAY L. WELFORD
Co-Chair, Legislative Committee

JUDITH GREENSTONE MILLER
Co-Chair, Legislative Committee

MARK SHIERIFF
President

Commercial Law League of America

Position Paper on S. 178 and H.R. 188 Permanent Reenactment of Chapter 12 of Title 11, United States Code Submitted to the United States House of Representatives and the United States Senate by The Commercial Law League of America and Its Bankruptcy Section

The Commercial Law League of America ("League "), 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 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 in interest.

The Bankruptcy Section of the League 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 strongly supports H.R. 188 and S. 178, which would make permanent Chapter 12 of the Bankruptcy Code (the "Code "), the provisions authorizing family farmer reorganization. The League urges prompt enactment of this legislation.

Since the 105th Congress, the existence of the family farmer reorganization provisions have been tenuous, subject to a series of sunset dates imposed by temporary extensions. During this time, the intent of Congress to make Chapter 12 permanent has been clear. Fulfilling this intent has been repeatedly stalled, however, because the necessary provisions to make Chapter 12 permanent have been included in controversial bills that sought extensive reform of the Code generally.

By all accounts, Chapter 12 has proven successful, enabling family farmers to reorganize within a specifically tailored bankruptcy structure. Prior to the enactment of Chapter 12, many family farmer bankruptcies failed simply because the existing Code provisions were unworkable in the unique circumstances involved in farming operations.

No evidence has been presented that Chapter 12 is not accomplishing the purpose for which it was designed. It appears to be a victim of the ongoing discussions relative to much more comprehensive and more controversial bankruptcy legislation.

Enacting the permanent extension of Chapter 12, as proposed in H.R. 188 and S. 178, will ensure that family farmers in need of reorganization are not denied meaningful bankruptcy relief. Too much uncertainty arises for existing Chapter 12 debtors from temporary extensions when, as in the past, gap periods occur during which there is no authority to utilize the chapter's provisions. A permanent extension of Chapter 12 independent of any other reform of the Code is the only means of protecting all parties involved, including current and potential family farmer debtors, as well as their creditors.

The League appreciates the opportunity to comment on H.R. 188 and S. 178. We would be happy to address the position taken by the League and its Bankruptcy Section in this Position Paper or to respond to questions or concerns raised by this analysis.

Statement of Consumer Mortgage Coalition

Mr. Chairman, the Consumer Mortgage Coalition ("CMC"), a trade association of national mortgage lenders and servicers, appreciates the opportunity to submit testimony to the Committee on S. 220, the "Bankruptcy Reform Act of 2001."

Impact of Bankruptcy In the Residential Mortgage Market

CMC acknowledges the potential societal benefit in providing relief for borrowers who are unable to pay their debts because of legitimate, unforeseen circumstances. At the same time, it must be recognized that the effect of bankruptcy on home mortgage lenders ("bankruptcy severity") ultimately affects the cost of residential mortgage loans or credit availability, or both. In making pricing and underwriting decisions, mortgage lenders consider the frequency of bankruptcy filings, the delays caused by such filings, the amount of debt recovered in bankruptcy, and the legal fees and other transaction costs involved. Delays are of particular concern to mortgage lenders because they lead to deterioration of the secured residence, which is being maintained by a debtor with little or no stake in the property. Too often, by the time the automatic stay is lifted by the bankruptcy court and the lender is permitted to foreclose upon and sell the residence, the proceeds of the sale are insufficient to pay the mortgage loan in full. Lenders who want to remain in business spread their mortgage loan losses to other borrowers in the form of higher interest rates. Any changes in the bankruptcy system that decrease bankruptcy severity will ultimately reduce the cost of home mortgages to the general public and will benefit creditworthy consumers who are seeking home mortgage financing.

Abusive Filings

There are a number of abuses of the bankruptcy process that prevent lenders from foreclosing, even when the debtor is clearly unable to pay the mortgage debt. Attached to this testimony is a case history (Appendix A) which illustrates the reason mortgage lenders are concerned with abusive filings. In this case, the debtor was able to delay foreclosure for more than a year through the simple technique of repeatedly conveying a partial interest in the mortgaged property to a third party, who then filed for bankruptcy relief under Chapter 7. The filing by the third party triggered the automatic stay, delaying foreclosure on the property by two to three months. When the judge dismissed the Chapter 7 filed by the third party, the debtor simply found another transferee to whom a partial interest was conveyed and who filed under Chapter 7 following the conveyance again triggering the application of the automatic stay to the mortgaged property.

In this case example, the debtor was able to obtain nine separate delays of the foreclosure sale, using five different transferees. The lender was finally able to obtain relief from the automatic stay by presenting evidence demonstrating to the court that the addresses—and even the existence—of the transferees could not be verified. Even after the court granted the motion for relief, the debtor again attempted the same technique, transferring a partial interest in the mortgaged property to yet another third party who immediately filed under Chapter 7. Unfortunately, the practice of transferring partial interests in mortgaged property to third parties who in turn file a bankruptcy petition to delay foreclosure has become more prevalent over the last few years. CMC would be pleased to present additional case histories to the Committee or its staff upon request.

In addition to the third party transferee abuse, a debtor may file a Chapter 13 petition, never make a single mortgage payment under the plan, voluntarily dismiss the case just before the hearing on the lender's motion to lift the automatic stay—and then file another petition just before the next foreclosure sale. Although these practices should subject the debtor to sanctions, the penalties in the current Bankruptcy Code are difficult to enforce.

S. 220, Mr. Chairman, addresses the above-described filing abuses. Section 302 amends Section 362 of the Bankruptcy Code to provide that if a case filed by a debtor under Chapters 7, 11 or 13 was dismissed and if the same debtor files a second case within a year of the dismissal, the automatic stay will terminate within 30 days of the filing of the second case unless the court extends the stay upon a finding that the second case was filed in good faith.

In addition, Section 303 of S. 220 addresses the situation in which a debtor transfers undivided interest in secured property to third party transferees by permitting the bankruptcy judge to grant in rem relief from the automatic stay. Properly applied, the in rem relief would prevent third party transferees who file a petition in bankruptcy from delaying foreclosure on property covered by in rem relief because the automatic stay would not apply to the covered property.

CRAMDOWNS

Several recent decisions have held that a lien on a residence securing a mortgage loan is subject to- cramdown in certain circumstances. A cramdown can negatively impact the lender's secured claim. In a cramdown, the secured claim—the amount due on the mortgage loan—is reduced to the amount of the lien that does not exceed the market value of the property. The remainder of the claim is considered unsecured, which reduces or eliminates its value.

In addition, the lender's remaining lien under a cramdown is subject to restructuring as a secured claim in the Chapter 13 plan, which can dramatically reduce its value. There have been cases, for example, in which a conventional mortgage loan with equal monthly payments to maturity was converted into one with small monthly payments and large balloon payment at maturity—which the borrower could not realistically be expected to be able to pay.

The United States Supreme Court in *Nobelman* v. *American Savings Bank*, 508 U.S. 324 (1993), disallowed cramdowns under a Chapter 13 on residential mortgage loans that constituted the debtor's principal residence. However, courts, such as the Third Circuit Court of Appeals in Hammond v. Commonwealth Mortgage Corporation of America, 27 F.3d 52 (3d Cir. 1994), have subsequently narrowed the reach of the Nobelman decision. Section 1322(b)(2) of the Bankruptcy Code provides that a Chapter 13 plan may not cramdown a "claim secured only by a security interest in real property that is the debtor's principal residence." (Emphasis added). The Third Circuit in Hammond narrowly read the term "only" and held because the mortgage lien on the principal residence contained language creating a security interest in fixtures, rents, escrow balance and the like—in addition to the lien on the real property—the mortgage lien was no longer entitled to protection from cramdowns under Section 1322(b)(2) of the Bankruptcy Code. Almost all residential real estate mortgages—including the standard Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) mortgage forms—contain language creating a security interest in fixtures, escrow balances, etc. The practical effect of decisions, such as Hammond, is to nullify the cramdown protections in the Bankruptcy Code as enacted by Congress and interpreted by the U.S. Supreme Court in Nobelman for the overwhelming majority of residential mortgages.

There are a number of reasons for according residential mortgage loans protection from the cramdown provisions of Chapter 13.

- Protecting residential mortgage loans against cramdown encourages lenders to make higher loan-to-value loans and to lend to borrowers to whom they might otherwise not lend at all. This in turn makes possible wider home ownership consistent with the national policy evidenced by tax benefits favoring home ownership and government-sponsored mortgage insurance programs.
- Prohibiting cramdowns on residential mortgage loans protects and supports the secondary market for home mortgages. A sizable portion of Fannie Mae and Freddie Mac mortgage loans, together with other residential mortgage loans, are sold into the secondary market. The existence of the secondary market encourages mortgage origination by providing greater access to capital with which to fund residential mortgage loans.

- If a debtor is permitted to cramdown a mortgage loan to the current market value of the residence securing the mortgage loan, he will be able to take advantage of a temporary decline in the value of his home to reduce the mortgage lender's secured claim. If the residence later increases in value following a cramdown, the debtor rather than the lender will obtain the benefit of the appreciation. This problem is not particularly serious in the case of other consumer collateral (such as automobiles or appliances) since those types of collateral depreciate in value over time. It is a serious problem (and a temptation to the debtor) in the case of a home mortgage, since a residence often fluctuates in value over the life of a mortgage loan.
- Since the procedures provided by real estate law for foreclosing on a residential mortgage loan are typically more formal, more cumbersome and provide greater protection to borrowers (e.g., through rights of redemption) than is the case with other types of consumer collateral, the borrower's need for the ability to cramdown a mortgage loan is less and the prejudice to the mortgage lender of taking away the protection from cramdown, when combined with the stricter limitations on the lender's ability to foreclose is greater.

Perhaps the best argument for protecting residential mortgage loans from cramdown was advanced by the Fourth Circuit Court of Appeals in its recent decision, *Witt* v. *United Companies Lending Corp*. 113 F.3d 508, (4th Cir. 1997) in which it noted that:

- We recognize that the effect of our decision will require the Witts to pay back the full amount of their home mortgage loan, making it harder for them to get 'a fresh start in life, after they have made a good-faith attempt to pay what they can.' Report at 32. As Justice Stevens recognized in Nobelman, '[a]t first blush it seems somewhat strange that the Bankruptcy Code should provide less protection to an individual's interest in retaining possession of his or her home than of other assets.' Nobelman, 508 U.S. at 332 (Stevens, J., concurring). Permitting the bifurcation of home mortgage loans, however, could make lenders more hesitant to make such loans in the first place. Although a broader reading of [section] 1322(c)(2) might help the Witts today, it could make it more difficult in the future for those similarly situated to the Witts to obtain any financing at all. Congress appears to have designed another important section, [section] 1322(b)(2), with this result in mind. See id. (stating that [section] 1322(b)(2)'s 'legislative history indicat[es] that favorable treatment of residential mortgagees was intended to encourage the flow of capital into the home lending market)'; Perry, 945 F2d at 64 (finding that [section] 1322(b)(2) 'was intended to make home mortgage money on affordable terms more accessible to homeowners by assuring lenders that their expectations would not be frustrated'); *Grubbs* v. *Houston Am. Sav. Ass'n*, 730 Fd 236 (5th Cir. 1984) (noting that the exception for home mortgages in [section] 1322(b)(2) 'was apparently in response to perceptions, or to suggestions advanced in the legislative hearings. . .that home mortgage lenders, performing a valuable social service through their loans, needed special protections against modification thereof (i.e., reducing installment payments, secured valuations, etc.)'). *Witt* at page 514.

Recognizing the importance of protecting residential mortgage loans from cramdown under a Chapter 13, Section 306(c) of S. 220 includes definitions of "debtor's principal residence" and "incidental property" clarifying that a lender's security interest in incidental property that is commonly conveyed with a principal residence to secure a mortgage loan will not remove the loan from the cramdown protections afforded under Section 1322(b)(2).

One additional cramdown issue merits consideration of the Committee. It relates to confusion that has arisen among various courts in differing jurisdictions as to whether mortgage loans secured by duplexes, triplexes and four-unit residences are entitled to protection from cramdown under Section 1322(b)(2).

The definition of "debtor's principal residence" in Section 306(c)(1) of S. 220 reads as follows:

(13A) 'debtor's principal residence'—

(A) means a residential structure, including incidental property, without regard to whether that structure is attached to real property; and

(B) includes an individual condominium or cooperative unit, a mobile or manufactured home, or trailer;

Language should be added to subsection (A) of the definition of "debtor's principal residence" to make it clear that the definition includes duplexes, triplexes and four-unit residences. The revised subsection (A) would read as follows:

(A) means a residential structure containing 1 to 4 units, including incidental property, without regard to whether that structure is attached to real property; and

The “1 to 4 units” language would resolve a conflict in jurisdictions. Courts have differed as to whether a duplex, triplex or four-unit residence in which the debtor/owner lives in one of the units and rents out the remaining units qualifies as a “debtor’s principal residence” protected from cramdown under Section 1322(b)(2). See *Lomas Mortgage, Inc.* v. *Louis*, 82 F.3d 1 (1st Cir, 1996) in which the First Circuit found that a triplex did not qualify as “debtor’s principal residence” under Section 1322(b)(2) and *Brunson* v. *Wendover Funding Inc.*, 201 B.R. 351 (Bankr. W.D.N.Y. 1996) in which the Bankruptcy Court for the Western District of New York found that a duplex did qualify as “debtor’s principal residence”.

The First Circuit in Lomas noted that the Supreme Court in Nobelman had determined that Congress enacted carmdown protection under Section 1322(b)(2) to encourage the flow of capital into the home lending market and went on to state that:

> If the antimodification provision [Section 1322(b)(2)] is meant to encourage home lending, then excluding multifamily houses would tend to harm (in revenue terms) those purchasing property in urban neighborhoods, where owner-occupied multi-unit housing would tend to be more common, and to favor those purchasing single-family homes, more common in suburbia. The theory is that lenders would face relatively more risk of modification [cramdown] in the case of default in urban areas, and interest rates on loans in those areas would rise accordingly. Lomas, 82 F.3d at 6.

The First Circuit noted that “extending the antimodification provision to multifamily houses would create a difficult line-drawing problem. It is unlikely Congress intended the antimodification provision to reach a 100-unit apartment complex simply because the debtor lives in one of the units.” Lomas, 82 F.3d at 6.

The First Circuit ended its decision by noting that “If we are wrong as to what Congress intended [in concluding that the antimodification provisions of Section 1322(b)(2) did not protect a triplex from cramdown], legislation can provide a correction.” The Burnson court shared the concern of the First Circuit in Lomas, noting that the Lomas:

> Court bemoaned a lack of ‘clear guidance’ on the question [of whether a multi-family residential property was subject to cramdown] from either the language or contemporaneous legislative history of Section 1322(b)(2). . .This Court shares the frustration of numerous other courts in attempting to interpret this statute which is impenetrable when sought to be applied to a single parcel of land upon which the Debtor resides but which contains two or more dwelling units. Brunson, 201 B.R. at 351.

As the First Circuit noted in Lomas, a number of residential properties, particularly in the Northeast, are comprised of duplexes, triplexes and four-unit residences. Clarifying that such properties would qualify as “debtor’s principal residence” for purposes of Section 1322(b)(2) with the result that mortgage loans secured by duplexes, triplexes and four-unit residences would not be subject to cramdown—would provide certainty to residential mortgage lenders. Such certainty would encourage the continued flow of capital into the 2 to 4 unit residential market.

The definition of “debtor’s principal residence” at Section 306(c)(1) of S. 220 should be modified to include language making it clear that that a “debtor’s principal residence” for purposes of Section 1322(b)(2) of the Bankruptcy Code includes a residential “structure containing 1 to 4 units.”

CONCLUSION

Mr. Chairman, CMC is very appreciative of the opportunity to present its views on issues of critical importance to the residential mortgage industry and to all American homeowners. We look forward to working with you and the other Members of the Committee and the staff in finalizing legislation to implement necessary and long overdue reforms to the Bankruptcy Code.

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 Senate Judiciary Committee in conjunction with its February 8, 2001 hearing on the Bankruptcy Reform Act of 2001 (S. 220).

ICSC is the global trade association of the shopping center industry. Its 40,000 members in the United States, Canada and more than 70 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 1999, shopping centers in the U.S. generated over $1.2 trillion in retail sales and over $47 billion in state sales tax revenue, and employed over 11 million people.

First and foremost, ICSC would like to commend Congress, and this Committee in particular, for its efforts over the past few years to enact meaningful bankruptcy reform legislation. We are hopeful that S. 220, introduced by Senator Charles Grassley (R–IA), will be swiftly enacted so it can end existing abuses of the bankruptcy system. Although all of ICSC's concerns are not addressed in S. 220, 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 several years, including Bradlees, Crown Books, Discovery Zone, Edison Brothers, Garden Botanika, General Cinema, Montgomery Ward, Paul Harris Stores, Planet Hollywood, Service Merchandise, and United Artists, just to name a few. According to industry sources, included in the total number of businesses filing Chapter 11 bankruptcies in 2000 are 176 companies with assets totaling $95 billion. It seems as if every week another longstanding business is declaring bankruptcy. Furthermore, as our nation's economy continues to soften, 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 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 of upscale ladies' shoes may enter into an agreement that restricts the tenant, or an assignee, from selling low quality, discounted footwear or 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.

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 S. 220 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 S. 220.

"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).

A recent notable case involves a children's educational retailer in the Boston-area in which a judge allowed the trustee to assign two of its unexpired leases to a jeweler and a candle shop, even though another children's educational retailer offered bids, albeit lower ones, on those leases.

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 S. 220 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 S. 220 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 S. 220 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 nonmonetary 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 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 nonmonetary 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, postrejection 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 S. 220 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 set off 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 are treated as an administrative priority for three years, and that any remaining rents due under the lease are 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.

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT
Houston, Texas 77002–2655

Chairman Orrin Hatch
Senate Judiciary Committee
Washington, DC 20510

Re: Section 1235, Bankruptcy Reform Act of 2000, Expedited Appeals of Bankruptcy Cases to Courts of Appeals

Dear Chairman Hatch:

Streamlining the bankruptcy appellate process is one of the most important bankruptcy reform goals that Congress can achieve. As an appellate court judge, a member of the National Bankruptcy Review Commission, and a former bankruptcy lawyer, I write to issue my support for expediting some bankruptcy appeals to the courts of appeals. By keeping this type of provision in the Bankruptcy Reform bill, Congress will: (1) eliminate excessive costs and delay; (2) promote efficiency, fairness and stability; and (3) bring much needed uniformity to bankruptcy and the American commercial law system. Contrary to the position taken by some appellate judges, authorizing direct appeals will not cause an undue burden on the federal courts of appeals.[1]

Enthusiasm for expedited appeals exists throughout the bankruptcy community. Its supporters include bankruptcy judges, lawyers, academics, and debtor and creditor representatives. Indeed, in a rare expression of unity, the National Bankruptcy Review Commission voted unanimously to recommend direct appeals.[2]

The present two-tier appellate system directs bankruptcy appeals first to the district courts and then to the courts of appeals. The policy reasons supporting the elimination, as far as practical, of federal district courts from the bankruptcy appellate process are overwhelming. Bankruptcy cases, recently rising to over one million a year, have immediate and far-reaching consequences for borrowers and lenders nationwide. These cases are a significant federal court responsibility. Not only do bankruptcy courts interpret the federal Bankruptcy Code, but their decisions form the core body of cases in American commercial law today. Despite the potential social significance of the decisions, and despite the Constitution's provision for uniform bankruptcy law, there is precious little uniformity in bankruptcy.

The present system discourages final rulings and uniformity in several ways. First, most participants in bankruptcy lack the resources to finance legal fees through two full stages of appeal. Since most bankruptcy claims are already heavily discounted, there is rarely enough money at stake to justify undertaking duplicative appeals in order to obtain binding precedent. Second, delay imposes high costs. Adding to the inherent delay from duplication is the fact that some federal district courts do not handle bankruptcy appeals expeditiously. Neglect by these courts creates incentives to file appeals for the purposes of delay, even as it discourages the pursuit of meritorious appeals.

The excessive costs and delays mean that courts of appeals are rarely called upon to issue bankruptcy precedents binding throughout their circuit. Unfortunately, district court opinions rendered at the first level of review are not considered binding on the bankruptcy courts. Consequently, bankruptcy law is variable, non-uniform, and lacking in stare decisis within individual judicial districts as well as nationwide. Many issues that could have been settled by circuit courts are subject to interminable and costly relitigation in case after case, because the current appellate process stymies the definitive resolution of issues by courts of appeals.

The current two-tier system is thus both legally inefficient and unfair to the hapless participants in bankruptcy.

Against the manifest deficiencies of this system, and the national impact of bankruptcy court and Bankruptcy Code decisions, some appellate judges fear that eliminating the district court appellate function will unbearably increase our workload. With due respect, I believe this fear is exaggerated.

The courts of appeals, while busy, are currently not overburdened. In fact, appellate filings for fiscal year 1999 fell 3%, after excluding some newly-counted original proceedings.[3]

The short-term impact of expediting bankruptcy appeals to the courts of appeals is unknowable, but there are several reasons to predict it will not be severe.[4] First, many appeals now filed for purposes of delay in the district courts would not be pursued to the courts of appeals. Second, the Bankruptcy Appellate Panels (BAP's) will remain available for bankruptcy appeals in several circuits or could be created in other circuits where they become necessary. BAP's will be selected by many litigants for strategic reasons that we cannot presume to assess.[5] Finally, devices such as appeals without oral argument and the growing use of appellate conference attorneys could screen and resolve many less consequential bankruptcy appeals.

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[1] I do not write in support of any particular form of direct appeals, because there are a number of possibilities in addition to § 1235 as now structured that would accomplish the same basic objective.

[2] See 1 National Bankruptcy Review Commission, Final Report of the National Bankruptcy Review Commission (Bankruptcy: The Next Twenty Years) 752–67 (1997). Then-Chief Judge Richard Arnold of the Eighth Circuit, who was at that time a member of the Executive Committee of the Judicial Conference of the United States, endorsed the direct appeal proposal when he attended the meeting where the Commission voted to support it.

[3] See Administrative Office of the U.S. Courts, Judicial Business of the United States Courts: 1999 Annual Report of the Director 15.

[4] Even if each appeal filed in the district courts in fiscal year 1999 went to the courts of appeals, that would amount to about 3,000, or at most, a 6t increase in the court of appeals docket. For the reasons stated, I question whether anything close to one-to-one equivalency would occur.

[5] In addition, to some litigants, the relative unfamiliarity of federal appellate court procedure might be a deterrent (albeit an irrational one) to appeal.

The long-term forecast for direct bankruptcy appeals is more optimistic. As unclear issues are resolved at the circuit level, there will be more stability in the initial bankruptcy process and less need for appeals.

As is the case with any changes in legal process, the courts of appeals can expect a period of somewhat increased bankruptcy appeals, followed by a leveling-off due to the growing effect of stare decisis. To measure the desirability of the change, one must consider the impact not only on the appellate courts but also on the bankruptcy system and the American commercial system it serves. In view of the very large benefits that will accrue from eliminating a wasteful and inefficient extra layer of bankruptcy appeals and from instilling more appellate certainty in bankruptcy, I think the complaints about an increased appellate caseload are misplaced.

Thank you for allowing me to comment on this vital element of bankruptcy reform.

Very truly yours,

HON. EDITH H. JONES

U.S. DEPARTMENT OF JUSTICE
OFFICE OF LEGISLATIVE AFFAIRS
Washington, DC 20530

Hon. Charles E. Schumer
United States Senate
Washington, DC 20510

Dear Senator Schumer:

The Administration is deeply concerned by the incidents of violence, vandalism, and harassment committed against family planning clinics: Some of these acts have resulted in the deaths and maiming of innocent people. The Administration believes that these unlawful activities must not be tolerated, and that when they are committed, those found liable should be held accountable under the law.

The Administration has a strong record of supporting efforts to end clinic violence. The Freedom of Access to Clinic Entrances (FACE) Act of which you were the principal House sponsor, and which the President signed into law, provides federal protection against unlawful and violent actions while it protects the right to engage in peaceful picketing and protest unaccompanied by force or physical obstruction. Violators of FACE are subject to criminal penalties of imprisonment, a fine or both. In addition, the court may also assess civil penalties for a particularly egregious offense or against a repeat offender. State clinic access laws and state and federal anti-racketeering laws are additional tools used to prosecute clinic violence. Yet, if offenders are able to escape the damages assessed under these laws, then they will gradually lose their effectiveness.

Unfortunately, some defendants found liable for clinic violence are abusing the bankruptcy system in an effort to shield themselves from civil monetary penalties assessed under these laws. More specifically, these defendants are filing for Chapter 7 to discharge their obligations to the victims of their clinic violence and to escape responsibility for their actions. In order to stem the tide of clinic-related violence by ensuring that penalties for these acts are strictly enforced, we support your amendment that would make court-ordered fines and debts resulting from clinic violence nondischargeable.

The Administration's general position has been to oppose the expansion of nondischargeable debt unless there is an overriding public policy objective to be protected and no other way to achieve that objective. Consistent with this position, we view your amendment as a necessary tool in our current efforts to end illegal clinic violence and intimidation.

Certainly, one could argue that damages awarded- for all intentional torts should be nondischargeable. Indeed, this is largely the case under the "willful and malicious injury" exception contained in Section 536(x)(6) of the Bankruptcy Code. Some damages resulting from clinic-related violence, however, are not protected under this exception. This was made clear in the Supreme Court's recent decision in *Geiger* v. *Kawaauhau*, 523 U.S. 57 (1998). In *Geiger* the Court held that the word "willful" "modifies the word 'injuy' indicating that nondischargeability takes a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury. . ." Although some clinic=related violence is not committed with the direct intention to inflict injury, some such violence indirectly may result in injury. Take for example a family planning clinic that is blockaded, preventing all ingress and egress. Women who need essential medical services—some unrelated to abortion—may be denied those services; resulting in serious physical harm. Should damages awarded to victims such as these be any less protected simply because the blockader did not intentionally intend to injure these victims?

In addition, there is another compelling reason to create a specific nondischargeability carve-out for clinic-related violence damages. There are reports of-those who have been found liable for such acts blatantly—even enthusiastically—announcing how they are going to escape responsibility for their actions by filing for Chapter 7. Indeed, such abuse of the bankruptcy system appears to be part of a concerted plan on the pant of these individuals to perpetuate their acts of violence and intimidation.

Parties on both sides of the issue of abortion agree that violence against clinics should not be tolerated. This is why we have laws in place designed to deter such activity. We must not permit those who have committed odious acts of violence to escape responsibility for their actions. Your amendment furthers our efforts toward achieving this goal.

Sincerely,

JON P. JENNINGS
Acting Assistant Attorney General

Statement of George J. Wallace, Eckert Seamans Cherin & Mellott LLC, Washington, DC

Chairman Hatch, Senator Leahy and Members of the Committee, thank you for this opportunity to express my views on consumer bankruptcy and H.R. 333, The Bankruptcy Reform of 2001, and particularly the impact of the bill upon low income women.

My name is George Wallace. I am a member of the law firm of Eckert Seamans Cherin & Mellott LLC and am resident in the Washington, D.C. office.

I represent the 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 S. 220 because it will take significant steps toward reforming today's consumer bankruptcy laws while at the same time preserving the basic bankruptcy discharge and repayment plan remedies for debtors who use bankruptcy responsibly.

Despite being well-intentioned, it is increasingly clear that our bankruptcy laws are susceptible of misuse. Everyone is by now familiar with the "means test" and how it would require approximately 10% of those who file chapter 7 who have the ability to repay a significant part of what they owe to do so. But an equally important flaw in the present bankruptcy system is that it can be used to significantly delay or defeat the payment of child support and marital obligations. S. 220 stops that misuse of the bankruptcy system. It assures that those who file for bankruptcy will continue to pay their child support obligations throughout the bankruptcy. If S. 220 is enacted, filing bankruptcy will no longer halt the payment of crucial child support payments to low income single parent families.

The most important change the bill makes to child support collection is to except child support collection orders from the automatic stay, require a chapter 13 debtor to be current in post-filing child support payments to confirm a plan, and stay current as well as pay all arrears in order to get a discharge. With these changes, the ability to use chapter 13 to delay payment of child support for up to 5 years is stopped. The bill also changes current law to place child support arrears in first priority (versus seventh under present law) in a chapter 7, extremely important if there are assets to be distributed. Other marital dissolution obligations, including indemnification obligations, are made clearly nondischargeable (unlike under present law which permits discharge under certain circumstances). Post- filing support arrears owed to the single parent must be paid in order to receive a discharge, unless waived by the custodial parent.

Some, however, have asserted that S. 220 would harm single-parent families, and especially those headed by women. One claim is that single parents trying to collect child support will lose out to credit card companies collecting nondischargeable debt. This claim is completely without foundation. In fact, the quite reforms in S. 220 extending in minor ways the provisions of present law on nondischargeable debts are unlikely to have a significant impact on collection of credit card debt. Moreover, the child support collection system Congress has mandated outside bankruptcy already gives the child support creditor extraordinary power to collect child support, both current and in arrears, except when the debtor goes into bankruptcy.[1] That is why it is recognized by child support collection professionals that child support always wins over competing creditors like credit card companies. Philip L. Strauss, Assistant District Attorney, City and County of San Francisco. Testified in 1999 before the House Committee on the Judiciary directly to this point:

"Some criticism has been raised that the 1999 Bankruptcy Reform Act would be detrimental to women and children because it would pit them against banks and credit cared companies for collection of nondischarged credit card debt. Although this argument has some surface logic, no support collection professional that I know deems this concern to be serious. . . .[*N*] *onbankruptcy law has so tilted the field in favor of support creditors that competition with financial institutions for the collection of postdischarge debts presents no problems for support creditors."*

Other have claimed that the means test will be excessively harsh on poor, single parent families, and particularly those headed by women, when they seek bankruptcy protection. Nothing could be further from the truth. To be impacted by the ability to pay provisions in this legislation as a practical matter, families would have to earn more than the State median income adjusted for family size. To put this inperspective, a family of four living in Alabama would have to earn over $46,000 annually before the "ability to pay" test would even be applied. In Connecticut, they would have to earn over $72,000. As you know, the vast number of single parent families with children survive on an income well below that amount.

Moreover, even when the ability to pay test comes into play, it will only require dismissal from chapter 7 if the debtor's net income shows that the debtor could pay more than $100 a month if the debtor has debts over $24,000, or a minimum of $10,000 is his debts are smaller. Poor families would not have such net income, and could remain in chapter 7. Thus, no matter how you look at it, S. 200's ability to pay test will have no impact on poor families. They will continue to have, as they have under present law, the choice to either file in chapter 7 or chapter 13.

Finally, vague claims have been made that in some fashion, other provisions of the bill will somehow make bankruptcy less available or less beneficial for low income families. When examined, these claims always evaporate. For example, some have urged that the requirement of pre-filing credit counseling burdens low income debtors who have a great deal of difficulty paying for their bankruptcy attorney. Yet the requirement is minor. You just have to go to a short (1 hour) training session approved by the United States Trustee, which can be over the phone or by internet. If there is an emergency, the debtor can file for bankruptcy and obtain the counseling within the next 30 days. Furthermore, obtaining credit counseling before filing bankruptcy generally benefits debtors. First, they obtain more information about their alternatives from a neutral source, not a bankruptcy professional trying to earn money from their filing. Second, some of them may be able to save themselves from bankruptcy through a credit repayment plan. They will save their credit rating and be rehabilitated more quickly. Finally, credit counseling teaches budgeting skills, crucial for the very poor struggling to make ends meet. On examination, there appears to be absolutely no basis to argue that these benefits somehow will hurt low income families, whether they are headed by women or men.

In summary, S. 220 is legislation which benefits low income families, particularly those headed by women. To the extent those families are dependent on child support, it makes major changes to bankruptcy law so that it can no longer be misused to delay or defeat the collection of child support. Moreover, its provisions aimed at those who would abuse the bankruptcy system in other ways will not affect the honest, poor debtor needing relief from debts he has no hope of repaying. Finally, the bill contains provisions such as the credit counseling provisions, which will improve

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[1] Child support obligations take precedence over all other debts, and Congress has given extraordinary powers to assist in its collection Today, a custodial parent owed child support can obtain free or at a minimal cost (the maximum charge for collection is a one time fee of $25, waived by many states) a child support collection lawyer employed by the state or municipality whose only job is to collect child support. That lawyer has the power to withhold child support from the non-custodial parent's income of payment to the mother and children. The child support creditor also has a blanket, automatic lien arising upon nonpayment on all of the debtor's personal property. In addition, failure to make child support payments will result in the loss of a motor vehicle operators license, professional license (such as a physician's license, law license, etc.), or even jail. Faced with loss of the driver's license if he doesn't pay child support, the debtor will always pay that first, if he can pay anything at all.

the assistance that the bankruptcy system provides debtors who need debt relief and help in reorganizing their finances.

Thank you for the opportunity to address the Committee, and I urge your strong support for S. 220.